THE BOOK WAS DRENCHED

PUBLIC POLICY

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PREFACE

Although no single discipline in the social sciences can plot the course of public policy, specialists from various fields may each in turn promote a better understanding of questions confronting government today. It is our hope that this volume will serve not only to make available studies growing out of our seminar program but also to invite contributions from others who are interested in examining public policy from this angle. In *Public Policy* the studies brought together will reflect the approaches of the lawyer, the economist, the political scientist, and the administrator toward a variety of important public problems.

The attitude of the Graduate School of Public Administration at Harvard has been frankly experimental from the outset. This volume is offered in the same spirit. Our emphasis in the School is chiefly upon research. It is our hope that *Public Policy* will present periodically reports on various aspects of research in the broad field of public administration. Our contributors are not offering ready-made solutions to public problems but rather attempts at clarification and analysis from their distinctive points of view.

JOHN H. WILLIAMS, *Dean*
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INTRODUCTION

In presenting to the public this volume entitled *Public Policy*, the editors feel the desire to state clearly the purposes of the new publication and to guard against certain misunderstandings. It is hoped that the volume may become a yearbook in the field of public policy of the Harvard Graduate School of Public Administration. There exist many serial publications in the social sciences. What is the place of this new venture? It is our feeling that there is both a theoretical and a practical need.

The much discussed expansion of governmental activity calls for constant evaluation of public policies. Yet the elaborate distinctions which have been evolved in the various social sciences have made increasingly difficult any concerted attack upon public policy. The important issues and many of the significant analytical advances in the field of the social sciences are now, and always have been, determined by public policy problems which press for solution. The relevance for monetary theory of the problems set by the Napoleonic and post-war periods offers an illustration which can easily be duplicated in other areas. At the same time, because public policy necessarily involves the entire society, questions are raised which cut across all the fields. Administration, economics, history, law, political science, and sociology — to mention only the most important — are reguired for the analysis of the conditions which determine the success or failure of whatever modern government undertakes. Public policy issues rarely, if ever, fit neatly into one of the fields of study which the traditional division of labor has imposed upon the social sciences. These issues defy fragmentation and demand the collaboration of related disciplines. The editors agree with a critic who writes, "To my mind, such an enterprise has a *raison d'être* only if it applies all possible approaches to this problem, breaking down some of the barriers between theoretical and practical analysis and between legal, economic and administrative points of view." Here is a great challenge. Far be it from us to claim that we have met it. We are conscious of having merely made a beginning.

It is not intended to cover annually all the current issues, or even all the important issues, of public policy. We do not wish to pretend to offer any panaceas or to tell the public and its govern-

ment what ought to be done. We are primarily desirous of showing how the work of scholarship and practical administration may be brought into closer and, we hope, fruitful contact. We hope annually to present some of the results of the type of collaboration between scholar and administrator which is being attempted at the Harvard Graduate School of Public Administration and similar institutions of learning.

The essays incorporated in each volume will not ordinarily be the result of collaboration between contributors who address themselves to a single issue. We particularly did not wish to force any artificial unity upon the present work. Rather it was our desire to bring together a number of studies which could illumine the trend away from narrow specialization and towards a more realistic approach. It so happens that this first volume has as its major theme industrial organization and control. Several of the essays are directed to those problems of policy which relate to industrial markets and business practices. We make no claim to have exhausted this theme, nor have we hesitated to include other studies which lie outside this particular focus. It is to be expected that in subsequent volumes the problem of integration will be solved partly by the nature of the problems which demand governmental action and partly by a growing *rapprochement* of the various disciplines which are concerned with public action.

All the social sciences are plagued with the dichotomy between the theoretical and the practical. To reassure ourselves, we consulted with several hundred social scientists. Most of them agreed with us that the volumes should merge the two approaches. We shall make every effort to follow that counsel.

The present volume is composed entirely of contributions from men who are associated with our work at Harvard or who have recently been affiliated with the Graduate School of Public Administration. It did not seem fair to ask others to join us in a new venture until it had proved its worth. Since the School of Public Administration is primarily a research institution, it is to be expected that the results of various studies there prosecuted will be continuously available for publication, but it is our hope that all scholars working on problems of public policy will feel that we are anxious to consider their work for inclusion in future volumes. We are particularly desirous of including significant contributions from government officials. For the rest, the editors are content to accept the dictum of a friendly critic who remarked,

"The proposed volume should not be addressed to scholars as an explanation of the perversity or stupidity of politicians, but to citizens, civil servants, and political leaders as an account of what light scholarship may throw on what is being done and what can be done."

C. J. Friedrich
E. S. Mason

The editors wish to acknowledge the valuable assistance which they received from Dr. Mary Reynolds, who acted as editorial assistant for this volume during 1938–39.

PUBLIC POLICY

PUBLIC POLICY AND THE NATURE OF ADMINISTRATIVE RESPONSIBILITY

Carl Joachim Friedrich

As the scope and functions of modern administration have widened, the difficulty of securing responsibility has greatly increased. Pious myth-makers have continued to take it for granted that in England, at least, the formal dependence of the Cabinet upon the confidence of the House of Commons — what used to be known as parliamentary responsibility — effectively insures responsible conduct of public affairs by officials, high and low. One of these mentors has gone so far as to suggest that the United States will never have a healthy political system until it adopts the British scheme by clear and direct constitutional amendment. To be sure, he advanced this "bold" advice prior to the events leading up to the Munich pact, but he had before him the British elections of 1931 and 1935, which admittedly provided the only check for holding the government responsible. A realistic analysis of responsibility must take account of these developments, so markedly out of tune with formerly accepted views regarding the nature of parliamentary influence.[1]

RESPONSIBILITY AND POLICY FORMATION

The starting point of any study of responsibility must be that even under the best arrangements a considerable margin of irresponsible conduct of administrative activities is inevitable. For if a responsible person is one who is answerable for his acts to some other person or body, who has to give an account of his doings (Oxford English Dictionary), it should be clear without further argument that there must be some agreement between such a responsible agent and his principal concerning the action in hand or at least the end to be achieved. When one considers the complexity of modern governmental activities, it is at once evident that such agreement can only be partial and incomplete, no matter

[1] See Clarence A. Dykstra, "The Quest for Responsibility," *American Political Science Review*, vol. XXXIII, no. 1 (February 1939), p. 1; also Charles Aiken, "The British Bureaucracy and the Origins of Parliamentary Policy," *ibid.*, vol. XXXIII, no. 1 (February 1939), p. 26, and vol. XXXIII, No. 2 (April 1939), p. 219.

who is involved. Once the electorate and legislative assemblies are seen, not through the smoke screen of traditional prejudice, but as they are, it is evident that such principals cannot effectively bring about the responsible conduct of public affairs, unless elaborate techniques make explicit what purposes and activities are involved in all the many different phases of public policy. It is at this point that the decisive importance of policy determination becomes apparent. Too often it is taken for granted that as long as we can keep the government from doing wrong we have made it responsible. What is more important is to insure effective action of any sort. To stimulate initiative, even at the risk of mistakes, must nowadays never be lost sight of as a task in making the government's services responsible. An official should be as responsible for inaction as for wrong action; certainly the average voter will criticize the government as severely for one as for the other.

Without a well-defined and well-worked-out policy, responsibility becomes very difficult to bring about. Yet such policies are the exception rather than the rule. Many of the most severe breakdowns in contemporary administration, accompanied by violent public reactions against irresponsible bureaucracy, will be found to trace back to contradictory and ill-defined policy, as embodied in faulty legislation. There are numerous familiar illustrations. Nor should it be imagined that legislation in this sense is merely embodied in the formal statutes passed by Congress or Parliament. An even more common source of contradictory policy is administrative rules and regulations adopted by the several departments in the process of executing the statutory provisions. In England the Report on Ministers' Powers (1932) dealt extensively with the field of delegated legislation and found that many of these regulations suffer from poor draftsmanship. There appeared to prevail a fairly irresponsible tendency to adopt such rules and regulations without much regard for public and parliamentary opinion. In the United States the situation has become equally bad. The courts have shown little aptitude for dealing with the situation. The general inclination has been to reject the idea of such delegated legislation, with highly objectionable results, such as the Supreme Court decision holding the AAA unconstitutional because of its wide delegation of legislative power.[2] Many of those who hailed the decision would be surprised to recall that Elihu

[2] *U. S. v. Butler et al., Receivers of Hoosac Mills Corporation*, 297 U. S. 1 (1936). See also *Schechter Poultry Corp. v. U. S.*, 295 U. S. 495 (1935).

Root, who certainly was no radical, declared in his presidential address to the American Bar Association:

Before these agencies (namely administrative commissions), the old doctrine prohibiting the delegation of legislative powers has virtually retired from the field and given up the fight. There will be no withdrawal from these experiments. We shall go on; we shall expand them, whether we approve theoretically or not, because such agencies furnish protection to right, and obstacles to wrong-doing, which under our new social and industrial conditions cannot be practically accomplished by the old and simple procedure of legislature and courts as in the last generation.[3]

With this view, any informed analysis of contemporary legislation must concur. In the light of the large amount of legislative work performed by administrative agencies, the task of clear and consistent policy formation has passed likewise into the hands of administrators, and is bound to continue to do so. Hence, administrative responsibility can no longer be looked upon as merely a responsibility for executing policies already formulated. We have to face the fact that this responsibility is much more comprehensive in scope.

POLICY-MAKING AND POLICY EXECUTION

It has long been customary to distinguish between policy-making and policy execution. Frank J. Goodnow, in his well-known work, *Politics and Administration*, undertook to build an almost absolute distinction upon this functional difference.

There are, then, in all governmental systems two primary or ultimate functions of government, viz. the expression of the will of the state and the execution of that will. There are also in all states separate organs, each of which is mainly busied with the discharge of one of these functions. These functions are, respectively, Politics and Administration.[4]

But while the distinction has a great deal of value as a relative matter of emphasis, it cannot any longer be accepted in this absolute form. Admittedly, this misleading distinction has become a fetish, a stereotype in the minds of theorists and practitioners

[3] Elihu Root, "Public Service by the Bar," address as president of the American Bar Association at the annual meeting in Chicago, August 30, 1916. Reprinted in *Addresses on Government and Citizenship*, Robert Bacon and James Brown Scott, eds. (Cambridge: Harvard University Press, 1916), p. 535.

[4] Frank J. Goodnow, *Politics and Administration* (New York: Macmillan, 1900), p. 22.

alike. The result has been a great deal of confusion and argument. The reason for making this distinction an absolute antithesis is probably to be found in building it upon the metaphysical, if not abstruse, idea of a will of the state. This neo-Hegelian (and Fascist) notion is purely speculative. Even if the concept "state" is retained — and I personally see no good ground for it — the idea that this state has a will immediately entangles one in all the difficulties of assuming a group personality or something akin to it.[5] In other words, a problem which is already complicated enough by itself — that is, how a public policy is adopted and carried out — is bogged down by a vast ideological superstructure which contributes little or nothing to its solution. Take a case like the AAA. In simple terms, AAA was a policy adopted with a view to helping the farmer to weather the storm of the depression. This admittedly was AAA's broad purpose. To accomplish this purpose, crop reduction, price-fixing, and a number of lesser devices were adopted. Crop reduction in turn led to processing taxes. Processing taxes required reports by the processors, inspection of their plants. Crop reduction itself necessitated reports by the farmers, so-called work sheets, and agreements between them and the government as to what was to be done, and so forth and so on. What here is politics, and what administration? Will anyone understand better the complex processes involved in the articulation of this important public policy if we talk about the expression and the execution of the state will? The concrete patterns of public policy formation and execution reveal that politics and administration are not two mutually exclusive boxes, or absolute distinctions, but that they are two closely linked aspects of the same process. Public policy, to put it flatly, is a continuous process, the formation of which is inseparable from its execution. Public policy is being formed as it is being executed, and it is likewise being executed as it is being formed. Politics and administration play a continuous role in both formation and execution, though there is probably more politics in the formation of policy, more administration in the execution of it. In so far as particular individuals or groups are gaining or losing power or control in a given area, there is politics; in so far as officials act or propose action in the name of public interest, there is administration.

The same problem may be considered from another angle.

[5] See Carl J. Friedrich, *Constitutional Government and Politics* (New York: Harpers, 1936), pp. 29ff. and elsewhere.

Policies in the common meaning of the term are decisions about what to do or not to do in given situations. It is characteristic of our age that most legislation is looked upon as policy-deciding. Hence policy-making in the broad sense is not supposed to be part of administration. While these propositions are true in a general way, they tend to obscure two important facts, namely, (1) that many policies are not ordained with a stroke of the legislative or dictatorial pen but evolve slowly over long periods of time, and (2) that administrative officials participate continuously and significantly in this process of evolving policy. To commence with the latter fact, it is evident that in the process of doing something the administrator may discover another and better way of accomplishing the same result, or he discovers that the thing cannot be done at all, or that something else has to be done first, before the desired step can be taken. In our recent agricultural policy, examples of all these "administrative" policy determinations can be cited, as likewise in our social security policy. The discussions now taking place in both fields amply illustrate these points. What is more, such administrative participation alone renders policy-making a continuous process, so much in a state of flux that it is difficult, if not impossible, to state with precision what the policy in any given field is at any particular time. But, if this is true, it follows as a corollary that public policy will often be contradictory and conflicting in its effects upon society. Our myth-makers, of course, remain adamant in proclaiming that this should not be so, and let it go at that. It is hard to disagree with them, but we still have to face the question of responsibility, seeing that policies are in fact contradictory and conflicting. Who is responsible for what, and to whom? To what extent does such responsibility affect the actual conduct of affairs? A complex pattern appears when we attempt to answer such questions.

Some time ago I pointed out that administrative responsibility had not kept pace with our administrative tasks. In relying upon the political responsibility of policy-making persons and bodies, we had lost sight of the deeper issues involved. At that time I wrote:

> . . . autocratic and arbitrary abuse of power has characterized the officialdom of a government service bound only by the dictates of conscience. Nor has the political responsibility based upon the election of legislatures and chief executives succeeded in permeating a highly technical, differentiated government service any more than the religious responsi-

bility of well-intentioned kings. Even a good and pious king would be discredited by arbitrary "bureaucrats"; even a high-minded legislature or an aspiring chief executive pursuing the public interest would be thwarted by a restive officialdom.

An offended commentator from the British Isles exclaimed loudly that if I imagined that to be true of England I was "simply wrong." But I think it would be easy to show that the officials of a seventeenth-century prince were more responsible, i.e., answerable, to him, their sovereign, than the officials of any modern democracy are as yet to the people, their supposed sovereign. In the comparison there was no judgment as to the positive amount of responsibility found in either. Admittedly, many commentators have dwelt at length upon the frequently irresponsible conduct of public affairs in Great Britain and elsewhere.

THE NEW IMPERATIVE: FUNCTIONAL RESPONSIBILITY

It is interesting that the administrators themselves attach so little weight to the influence of parliamentary or legislative bodies. Leading Swiss officials — and Switzerland has as responsible a government service as any country in the world — told the author that "responsibility of the public service in Switzerland results from a sense of duty, a desire to be approved by his fellow officials, and a tendency to subordinate one's own judgment as a matter of course. Still, in a case like the arrival of Social Democrats into the Federal Council, it might happen that official conduct would be slow to respond to the new situation." They also felt that officials are not unwilling to allow a measure to lapse, although actually provided for in legislation, if considerable opposition is felt which the public might be expected to share. Thus a wine tax was quietly allowed to drop out of sight, just as the potato control act remained a dead letter in the United States.[6] There are, of course, ways by which the legislature secures a measure of control that enables it to enforce responsibility, usually of the negative kind which prevents abuses. Legislative committees act as watchdogs over all expenditure.[7]

What is true of Switzerland and the United States without "parliamentary responsibility" seems to be equally true of Eng-

[6] See Schuyler C. Wallace, "Nullification: A Process of Government," *Political Science Quarterly*, vol. XLV, no. 3 (September 1930), p. 347.

[7] See George C. S. Benson, *Financial Control and Integration* (New York: Harpers, 1934).

land and France. In both countries complaints against the increasing independence of officials are constantly being voiced. In a very important discourse, Sir Josiah Stamp called attention to the creative role the civil servant is called upon to play in Great Britain. "I am quite clear that the official must be the mainspring of the new society, suggesting, promoting, advising at every stage." Sir Josiah insisted that this trend was inevitable, irresistible, and therefore called for a new type of administrator. An editorial writer of *The Times*, though critical of this development, agreed "that the practice, as opposed to the theory, of administration has long been moving in this direction." He added, "In practice, they (the officials) possess that influence which cannot be denied to exhaustive knowledge; and this influence, owing to the congestion of parliamentary business and other causes, manifests itself more and more effectively as an initiative in public affairs." Testimony of this sort could be indefinitely multiplied; and as we are interested in practice, not in ideology, we must consider the question of responsibility in terms of the actualities. Such cases throw a disquieting light upon the idea that the mere dependence of a cabinet upon the "confidence" of an elected assembly insures responsible conduct on the part of the officials in charge of the initiation and execution of public policy, when those officials hold permanent positions. It is no accident that the Goodnow school should fully share such illusions. After pointing out that the British Cabinet unites in its hands power of legislation and administration, and thus both formulates and executes policies, Goodnow remarks:

> So long as their action meets with the approval of Parliament . . . there is none to gainsay them. If, however, they fail to gain such approval . . . they must resign their powers to others whose policy is approved by Parliament. . . . In this way the entire English government is made responsible to Parliament, which in turn is responsible to the people.[8]

This is no longer very true. It is objectionable to consider administrative responsibility secure by this simple device, not merely because of interstitial violations but because there is a fundamental flaw in the view of politics and policy here assumed. The range of public policy is nowadays so far-flung that the largely inoperative "right" of the parliamentary majority to oust a Cab-

[8] Goodnow, *op. cit.*, p. 154.

inet from power belongs in that rather numerous group of rights for which there is no remedy. The majority supporting the Cabinet may violently disagree with this, that, and the other policy advocated and adopted by the Cabinet, but considerations of party politics, in the broadest sense, will throttle their objections because the particular issue is "not worth a general election" and the chance of the M.P.'s losing his seat.[9] As contrasted with the detailed and continuous criticism and control of administrative activity afforded by Congressional committees, this parliamentary responsibility is largely inoperative and certainly ineffectual. When one considers the extent of public disapproval directed against Franklin D. Roosevelt's Congressional supporters who were commonly dubbed "rubber stamps," it is astonishing that anyone extolling the virtues of British parliamentarism should get a hearing at all. For what has the parliamentary majority in Britain been in the last few years but a rubber stamp of an automatic docility undreamt of in the United States?

THE MODERN PHASE: ADMINISTRATIVE DISCRETION

British observers are not unaware of this development. Indeed, the Committee on Ministers' Powers, whose able report has already been cited, was created in response to widespread criticism of the irresponsible bureaucracy which was supposed to be developing. While Lord Hewart's *The New Despotism* undoubtedly exaggerated, his critical attack upon the growth of discretion allowed administrative agencies corresponded to a widespread sentiment. Unfortunately, his views were expressive of an unrealistic nostalgia for legal traditions which the forward march of social development has irrevocably assigned to limbo. Like Beck's *Our Wonderland of Bureaucracy,* Lord Hewart's denunciation of policy-determining officials failed to take into account that this "bureaucracy" had arisen in response to undeniable needs, and that therefore the real problem is how to render these functionaries responsible, not how to take all power away from them. The Committee on Ministers' Powers addressed itself to the real task. They set out to reduce the extent of the rule-making power of administrative agencies and to subject the making of such rules and regulations to a measure of parliamentary control. A standing committee of each house was to scrutinize bills with a view to whether

[9] See Ramsay Muir, *How Britain is Governed* (New York: Richard R. Smith, Inc., 1930), pp. 81–91, 120–132.

they contained any such delegated legislative power, and, if so, to report upon the provisions in the light of given standards. Without going into the details of these recommendations — for they have not been put into effect — it must be said that they fail to cope with the decisive issue, the responsibility of officials for the policy adopted. No doubt technical improvements would result here and there, errors would be corrected, and mistakes avoided. But wherever the acquisition of discretionary rule-making power would be considered desirable by the government in power, or its exercise in a particular instance justifiable in terms of its policies, it is scarcely probable that under the British parliamentary system a committee composed of a majority of the government's party would cause any real difficulties. Either in getting such discretionary power on the statute books, or in exercising it as the permanent officials see fit, the government's view is more than likely to prevail.

The Report itself is illuminating on this score, though it soft-pedals the real trouble. The Report states that tactical considerations of party politics will play a role, and that, as realists, the committee members recognize it. An interesting illustration is afforded by their discussion of the so-called "Henry VIII Clause." This clause bears its nickname reminiscent of Tudor absolutism because it empowers the appropriate minister to modify the provisions of an act he is called upon to administer so far as may appear to him necessary for the purpose of bringing the act into operation. A number of important statutes in the last few decades contain such a clause. By way of illustrating the inevitability of such a clause, the Report remarks that the Committee had been assured that the National Insurance Act, 1911, could never have been brought into operation without the powers conferred by the Henry VIII Clause. Furthermore, it says:

> We have been told, rightly or wrongly, that if that Bill had not passed into law in 1911, the chance of it passing the Parliamentary ordeal with success in 1912 or 1913 would have been small; with the result that a social measure . . . of far-reaching importance would never have passed at all. In other words, the practical politician has to seize the tide when it serves or may lose his venture. We admit this truth: and because we admit it, we consider that the Henry VIII clause is a political instrument which must (*sic*) occasionally be used.[10]

[10] Committee on Ministers' Powers, *Report* (London, 1936; Cmd. 4060), p. 61.

The Committee recommended, of course, its sparing use and all that, but the only sanction they could think of was a parliamentary standing committee dominated by the government's majority. Evidently, a monarch could count on his officials' acting more nearly responsibly and in accordance with his will than the people can under such arrangements.

A DUAL STANDARD OF ADMINISTRATIVE RESPONSIBILITY

But are there any possible arrangements under which the exercise of such discretionary power can be made more responsible? The difficulties are evidently very great. Before we go any further in suggesting institutional safeguards, it becomes necessary to elucidate a bit more the actual psychic conditions which might predispose any agent toward responsible conduct. Palpably, a modern administrator is in many cases dealing with problems so novel and complex that they call for the highest creative ability. This need for creative solutions effectively focuses attention upon the need for action. The pious formulas about the will of the people are all very well, but when it comes to these issues of social maladjustment the popular will has little content, except the desire to see such maladjustments removed. A solution which fails in this regard, or which causes new and perhaps greater maladjustments, is bad; we have a right to call such a policy irresponsible if it can be shown that it was adopted without proper regard to the existing sum of human knowledge concerning the technical issues involved; we also have a right to call it irresponsible if it can be shown that it was adopted without proper regard for existing preferences in the community, and more particularly its prevailing majority. Consequently, the responsible administrator is one who is responsive to these two dominant factors: technical knowledge and popular sentiment. Any policy which violates either standard, or which fails to crystallize in spite of their urgent imperatives, renders the official responsible for it liable to the charge of irresponsible conduct.

In writing of the first of these factors, technical knowledge, I said some years ago:

> Administrative officials seeking to apply scientific "standards" have to account for their action in terms of a somewhat rationalized and previously established set of hypotheses. Any deviation from these hypotheses will be subjected to thorough scrutiny by their colleagues in what is known as the "fellowship of science." . . . If a specific designation were

desirable, it might be well to call this type of responsibility "functional" and "objective," as contrasted with the general and "subjective" types, such as religious, moral and political responsibility. For in the former case, action is tested in terms of relatively objective problems which, if their presence is not evident, can be demonstrated to exist, since they refer to specific functions. Subjective elements appear wherever the possibility of relatively voluntary choice enters in, and here political responsibility is the only method which will insure action in accordance with popular preference.[11]

Similarly, John M. Gaus writes:

The responsibility of the civil servant to the standards of his profession, in so far as those standards make for the public interest, may be given official recognition. . . . Certainly, in the system of government which is now emerging, one important kind of responsibility will be that which the individual civil servant recognizes as due to the standards and ideals of his profession. This is "his inner check." [12]

Yet this view has been objected to as inconceivable by one who claimed that he could not see how the term "responsibility" could be applied except where the governed have the power to dismiss or at least seriously damage the officeholder.[13] Thus, with one stroke of the pen, all the permanent officials of the British government, as well as our own and other supposedly popular governments, are once and for all rendered irresponsible. According to this commentator, political responsibility alone is "objective," because it involves a control by a body external to the one who is responsible. He also claims that its standards may be stated with finality and exactitude and its rewards and punishments made peremptory. For all of which British foreign policy leading up to Munich no doubt provides a particularly illuminating illustration.

It seems like an argument over words. The words, as a matter of fact, do not matter particularly. If you happen to feel that the word "objective" spells praise, and the word "subjective" blame, it may be better to speak of "technical" as contrasted with "political" responsibility, or perhaps "functional" and "political"

[11] Carl J. Friedrich, "Responsible Government Service under the American Constitution," *Problems of the American Public Service* (New York: McGraw-Hill, 1935), p. 38.

[12] John M. Gaus, "The Responsibility of Public Administration," *The Frontiers of Public Administration* (University of Chicago Press, 1936), pp. 39–40.

[13] Herman Finer, "Better Government Personnel," *Political Science Quarterly*, vol. LI, no. 4 (December 1936), pp. 569ff., esp. pp. 580ff.

will appeal. Whether we call it "objective" or "functional" or "technical," the fact remains that throughout the length and breadth of our technical civilization there is arising a type of responsibility on the part of the permanent administrator, the man who is called upon to seek and find the creative solutions for our crying technical needs, which cannot be effectively enforced except by fellow-technicians who are capable of judging his policy in terms of the scientific knowledge bearing upon it. "Nature's laws are always enforced," and a public policy which neglects them is bound to come to grief, no matter how eloquently it may be advocated by popular orators, eager partisans, or smart careerists.

POLITICAL RESPONSIBILITY

The foregoing reflections must not deceive us, however, into believing that a public policy may be pursued just because the technicians are agreed on its desirability. Responsible public policy has to follow a double standard, as we stated before. We are entirely agreed that technical responsibility is not sufficient to keep a civil service wholesome and zealous, and that political responsibility is needed to produce truly responsible policy in a popular government. Discarding the wishful thinking of those who would tell us that Great Britain has solved this difficult problem, it is first necessary to repeat that such truly responsible policy is a noble goal rather than an actual achievement at the present time, and may forever remain so. All institutional safeguards designed to make public policy thus truly responsible represent approximations, and not very near approximations at that. One reason is the intrusion of party politics, already discussed; another is the tremendous difficulty which the public encounters in trying to grasp the broader implications of policy issues, such as foreign affairs, agriculture, and labor today. Concerning unemployment, all the general public really is sure about is that it should disappear. Many people, in defending Hitler, declare that, after all, he did away with unemployment. If you try to object by explaining what tremendous cost in national welfare this "accomplishment" has entailed, the average citizen is apt to be bewildered. "After all . . . ," he reiterates.

THE ROLE OF CITIZEN-PARTICIPATION

There are, of course, those who would altogether deny the impact of the people or its representatives, whether Congress or

Parliament, upon the emerging policies. Such observers assert that even the most far-reaching of public policies are often formed by executive agencies under the pressure of circumstances and are merely legalized by subsequent legislation. It was thus recently put by an able student of our labor policy:

> It is a problem for the bureaucracy to foresee a situation and evolve a solution which will break gradually upon the political consciousness and be sufficiently entrenched so that its formal adoption in the legislative chamber is not an embarcation upon an uncharted sea.

Lest our British friends rush in to tell us that this is another American heresy, let me hasten to add that a similar view is even more common among British students of these matters, and quite naturally, since the role of the permanent administrative group in the drafting of legislation is so much more openly acknowledged under the cabinet system of government. Indeed, apropos the previously quoted address of Sir Josiah Stamp the commentator in *The Times* felt it necessary to remark upon the neglect of Parliament which Sir Josiah's views seemed to spell. Nor is this trend so very novel. Long before the war Sir Eyre Crowe, a leading permanent official of the Foreign Office, once wrote a confidential memorandum on parliamentary and public influence upon the course of British foreign policy. He stated that there was very little or none; he could recall only one instance, the Venezuela imbroglio, when the Foreign Office had been obliged to change its policy in response to public opinion. But it is our opinion that Sir Eyre Crowe, as well as all others who maintain the virtual aloofness of the permanent administrator from politics, are deceiving themselves. It is our view that such officials are more or less responsible to the people and its representatives, the press and Parliament, right along. Sir Eyre Crowe forgot that policy-making officials deliberated almost daily upon what would be the reaction of the public to this, the reaction of Parliament to that move. By correctly anticipating these reactions, the Foreign Office avoided getting embroiled and having to reverse its course. Who can say, then, that it was free from influence by Parliament and the public?

The same thing would, I believe, be found to be true here. The mere knowledge that the representative assemblies can stop a policy from going forward, that a row in the public press may destroy all chances of initiating an activity which the administrator holds to be desirable, will make him keenly interested in and de-

sirous of anticipating the reactions of public and Parliament or Congress alike. Too little attention has been directed to the fact that political influence works most effectively through such anticipation, rather than through the reversal of policies after they have been adopted. But while the press and Parliament still provide very potent sources of influence, and hence their reactions are keenly watched by policy-formulating officials, newer and equally potent instruments have been developed in recent years. Through its informational services, administrative officials have begun to tap independent sources of insight into the views and reactions of the general public which are increasingly important in guiding them towards the making of public policy in a responsible fashion.

It is quite common to look upon the informational services which are being developed in this country at the present time as largely devoted to the handing-out of routine news items to the daily press. A more comprehensive discussion of these activities is not intended here. Their many-sided function is being increasingly recognized. In fields with novel policies to administer, such as Social Security or AAA, educational and promotional functions are being recognized. But along with all this outward flow of information on emerging policies, there is an ever-increasing quantity of intake. This intake of all sorts of communicable views, opinions, facts, and criticisms is becoming a potent factor in the shaping of public policy, particularly in areas where the government is entering new or experimental ground. But even in established realms of governmental activity new lines of approach are being pushed as a result of the activity of informational services. It is the function of the administrator to make every conceivable effort toward the enforcement of the law which he is called upon to administer. The authoritarian tradition of the past was inclined to take the attitude that it was up to the citizen to find out what the law was; if he did not, it was just too bad. Ignorance was no excuse. This conception of the government as mere police is quite outmoded, though undoubtedly many government offices are still administered according to such outworn notions. The modern conception of government as the largest "public service" with vast and diversified activities to administer cannot be made to work in such terms. The continuously changing pattern of our society requires that the administrator be responsive to whatever trends may be affecting his activities. Laws do not embody static and universal truths; they represent expedient policies which are subject

to continuous change and must be so considered. Instead of administering according to precedent, the responsible administrator today works according to anticipation. Within the limits of existing laws, it is the function of the administrator to do everything possible which will make the legislation work. The idea of enforcing commands yields to the idea of effectuating policy. For most of the policies of a modern government, at any rate under democratic conditions, require collaboration rather than force for their accomplishment.

It is very natural that policies which are novel in their creative impact upon society should elicit a great many diverse public reactions. These will flow into the administrative offices in the form of inquiries, criticisms, and suggestions. Under democratic conditions, the average citizen feels entirely free to communicate with the government, because he considers it his own. According to the traditional conception of representative government, such communications would be sent to the citizen's representative in Congress or Parliament, who in turn would make them the basis of suitable action, official or unofficial inquiries, remarks in the debates of the House, and so on. A great deal of public reaction still takes this form, and, while elected representatives at times are inclined to feel that their mail is getting to be too much of a good thing, they would surely be agreed that the more important communications of this kind constitute an intrinsically valuable source of information and guidance. In Great Britain, the question hour still serves this purpose fairly well. In the United States much would depend upon the representative's being a member of the strategically important committees. However, the great pressure of legislative work has made it increasingly difficult for parliamentarians to attend to such matters. Moreover, a citizen, no matter how competent or well-informed, would be handicapped if his views were patently different from those of the representatives, whether for political or technical reasons. It is evident that in these and similar situations the citizen has become more and more accustomed to turn directly to the administrator. Some far-sighted administrators, like M. L. Wilson, Undersecretary of Agriculture, have made persistent efforts to secure such citizen-participation. Actually, referenda have been held to ascertain what would be the reaction of large groups of affected citizens to a proposed policy. On December 10, 1938, the United States Department of Agriculture held a regular referendum to determine AAA crop

control.[14] Other such consultations have been held on a more limited scale on potatoes, milk, and the like. The Social Security Board, from its very inception, has realized the extent to which citizen-interest must be aroused and citizen-coöperation maintained in order to realize the far-flung policies which the Act had embodied into law. Hence the Board's information service has been called upon to advise the Board and its various bureaus and the regional and field offices not only on public relations matters but on all policy matters which affect public relations of the Board and its agents. Markedly similar conceptions prevail in the Department of Agriculture, more particularly the AAA, and many other agencies. Indeed, there has lately developed an interesting tendency for administrative authorities to avail themselves of the large mail Congressmen receive on all sorts of questions. A Senator may just pass on to the administrator the letters he is receiving, or he may add his own comments from time to time. A representative is apt to be rather alert concerning the attitudes prevailing among his constituency; he is bound to become a specialist in public relations after a bit of experience! Hence legislators can often gauge much more accurately than an administrator what the significance of a particular communication might be. This tendency represents an interesting modern adaptation of the question hour in the House of Commons.

It seems that the United States federal government has gone farther than any government abroad in developing such direct citizen participation in policy formation at the administrative level. This much may be asserted, even though in the field of agriculture the Scandinavian countries and Switzerland have progressed rapidly in the same direction. The whole movement suggests a significant shift of emphasis, when contrasted with the legislative referendum so characteristically molded by Switzerland and developed throughout the United States. Perhaps federal leadership in this sphere is not wholly unrelated to the fact that we have refused to extend the earlier referendum procedure to that sector of our government. But, quite apart from that, it is a rather natural development, compensating democratically for the gradual disappearance of effective legislation by individual members of legislative assemblies. As a result, the basic pattern of securing responsibility has been altered. Put quite broadly, it may be said that the public relations work of the administrative

[14] See *New York Times*, December 11, 1938, p. 1.

agencies has the task of anticipating clashes between the administrative efforts at effectuating a policy and the set habits of thought and behavior of the public which constitutes its "environment." There is, we might say, a laudable tendency here to adopt the department store slogan: "The customer is always right." For if such friction develops, the presumption exists that there is a flaw in the policy or in the methods by which the policy is being administered. Many questions asked of the information services of important federal agencies have no answer. The questions raise issues of policy which either have not been anticipated, or at least have not been settled by the administrative officer involved, or reported back to Congress for settlement.

SHALL WE ENFORCE OR ELICIT RESPONSIBLE CONDUCT?

Those old-timers who are enamored of strict subserviency undoubtedly will be inclined to argue that the foregoing is all very well, but that it depends entirely for its effectiveness upon the good will of the administrator, and that as soon as he is indifferent or hostile to such public reactions he can and will discard them. There is unquestionably some truth in this objection. Responsible conduct of administrative functions is not so much enforced as it is elicited. But it has been the contention all along that responsible conduct is never strictly enforceable, that even under the most tyrannical despot administrative officials will escape effective control — in short, that the problem of how to bring about responsible conduct of the administrative staff of a large organization is, particularly in a democratic society, very largely a question of sound work rules and effective morale. As an able student of great practical experience has put it:

> This matter of administrative power commensurate with administrative responsibility, or the administrator's freedom from control, is not, under our system of government, anything absolute or complete: it is a question of degree. . . . Nothing which has been said should be construed to mean that preservation of administrative freedom, initiative and resourcefulness is not an important factor to be considered in organization: quite the contrary, it is one of the major factors.[15]

The whole range of activities involving constant direct contact of the administrator with the public and its problems shows that our

[15] Lewis Meriam, *Public Personnel Problems* (Washington: Brookings Institution, 1938), p. 340.

conception of administrative responsibility is undergoing profound change. The emphasis is shifting; instead of subserviency to arbitrary will we require responsiveness to commonly felt needs and wants. The trend of the creative evolution of American democracy from a negative conception to a positive ideal of social service posits such a transformation. As the range of government services expands, we are all becoming each other's servants in the common endeavor of operating our complex industrial society.

It seems desirable to consider one further problem of especial significance in this area, and that is the role and the importance of satisfactory relations of the government to its employees of all ranks and classes. Private employers are becoming increasingly aware of the decisive role which all their employees must play in the public relations of business concerns. Competition through service is becoming an ever more important factor, and the contact of the general public with particular businesses is through their employees. It is evident that the government through its expanding services is placed in a similar position.[16] The Postal Service has long recognized this and has evolved careful regulations concerning the dealings of its employees with the public. As a result, the letter carrier has become a symbol of cheerful service. By contrast, the arbitrary official of authoritarian regimes abroad has always been acknowledged as the antithesis of democracy. Although such conduct was often condoned as part of administrative efficiency, we know today that this view is mistaken. Just as morale within the service is of decisive importance in bringing about responsible administration, so likewise morale should extend beyond the confines of the service itself.

The most serious issue revolves around the problem of the employees' right to organize, to bargain collectively, and to strike if their demands are rejected. It is difficult to see how popular government can recognize a right to strike, though it seems equally questionable to deny it. Whatever the abstract arguments, the right to strike is not recognized by most democratic governments. At any rate, most public employees recognize that such strikes really are not in their true interest. But it is obvious that in lieu

[16] These trends were discussed at a conference on personnel problems held at the Brookings Institution, under the auspices of the Harvard Graduate School of Public Administration, in 1938. See manuscript, "Report of a Conference on the Relations of Personnel Problems and Public Relations, February 3, 1938," now at the Littauer Center of Public Administration, Harvard.

of the possibility of bringing their complaints and grievances forcibly to the attention of their employer, the government, government employees must be provided with exceptionally well-ordered institutional safeguards for mediation and arbitration. Such mechanisms have a fairly long tradition in some countries; they are rapidly developing in this country. The American Federation of Government Employees has always staunchly defended this right of government employees to organize and present their views collectively. Recently, a C.I.O. union, the United Federal Workers of America, has taken an even more militant attitude, including a demand for the recognition of the right to strike. Here again, it is evident, a democracy has to face the issues which are being raised by the ever-expanding size of its administrative activities. It cannot possibly hope to develop and maintain responsible conduct unless it accords its employees a status at least equal in dignity and self-respect to the status its labor laws impose upon and demand from private employers. In short, even though the government did not feel justified in conceding the right to strike, it should not discriminate against employees who join an organization which advances this claim. For merely to demand this right is not a crime, since reasonable men may differ as to the right answer. Employees who are denied the rights of ordinary citizens cannot possibly be expected to remain loyal and responsible public servants.

The right policy is to be sure that all necessary disciplinary rules are loyally accepted by the entire staff, irrespective of what organization they belong to. This formula works well as long as those responsible for the rules respect the rights of the persons working under them. It must be kept in mind, however, that there are quite a few difficult border-line cases, where the infraction of a given rule has been due to faulty behavior or hostile attitudes on the part of the higher-ups. Some time ago two or three members of the staff of a certain agency in Washington stayed away from the office to attend a hearing at the Civil Service Commission which bore upon an important point at issue between themselves and their agency. When their superiors learned of it, they wanted to fire them, because these employees had stayed away from the office without permission, which the disciplinary rules forbade them to do. But the men pointed out that their superiors were so hostile to their C.I.O. union that permission to attend the hearing would have been refused. It is evident that in such a case the

rule is at fault, since members of the staff duly appointed to represent it should be free to leave the office to attend a hearing at the arbitral authority, such as the Civil Service Commission, without asking permission to go. The possible frictions of this type are endless; it is evident that adequate representative organization of the employees is the only possible way of coping with the situations as they arise.

Another important problem which is closely related to the foregoing, and equally controversial, is the right of officials to talk and write about issues of general public policy, more particularly those on which they themselves possess exceptional information and understanding because of their official position. There was a time when officials were supposed never to speak their mind in public. But the American and other democratic governments have gradually relaxed these restrictions. It must seriously be doubted whether technical responsibility, which, as we have shown, is coming to play an ever more important role in our time, can be effectively secured without granting responsible officials considerable leeway and making it possible for them to submit their views to outside criticism. The issue is a very complex one. Opinions vary widely. People try to escape facing these difficulties by drawing facile distinctions, such as that officials might discuss facts but not policy. It might cogently be objected that facts and policies cannot be separated. Any presentation of facts requires a selection, and this selection is affected by views, opinions, and hence bears upon policy. What is worse, in many of the most important matters intelligent and well-informed students disagree frequently on what are the facts.

The simplest solution, and one to which the authority-loving politician has recourse without much hesitancy, is to forbid such public utterances altogether. It is undeniable that great inconveniences might and often do result from technical authorities' bringing out "facts" which make the official policy appear in a questionable light. Hence instances of "gag rules" are quite frequent. At one time a federal department head ruled that no official in his organization was to give any more interviews, because one of them had annoyed him. Thereupon six reporters proceeded to that department and got six different stories, all of which were printed and sent to the administrative head to show him that his rule had been foolish and could not really be enforced. In this case the power of the press forced the abandonment of an unsound

policy which would seriously interfere with making the administration responsible in the formulation and execution of policy. While many cautious administrators will aver that an official should not discuss policy, it seems wiser, in a democracy, to avoid such a gag rule. Many officials will hesitate to express themselves, anyway, for obvious reasons. A great deal depends upon the nature of the case. In matters of vital importance the general public is entitled to the views of its permanent servants. Such views may often provide a salutary check on partisan extravagances. Such views should be available not only to the executive but to the legislature and the public as well. Gag rules seek to insulate the specialist so that he is no longer heard. A large benefit is thus lost. Irrespective of what one thinks of the particular policies involved, a presidential order not to talk against administration bills to Congress is particularly doubtful, for Congress certainly is entitled to the advice and expert opinion of permanent officials of the government, who may be presumed to have a less partisan viewpoint on particular policy proposals. In fact, the rule can easily be circumvented by an official determined to make his views known: he can prime Congressional questioners to ask the right questions, and, as the officials must answer, their views become available to whole committees. This is true, but while it is alleged that no president would dare punish a man for what he says in answer to a Congressional query, it may often seem to the official undesirable to incur the presidential wrath. Hence no such rule should be allowed at all.

What applies to enlightening Congress really applies likewise to a wider field. It seems inexcusable that highly trained professional economists, for example, should be handicapped in addressing themselves to their colleagues in a frank and scientifically candid manner. Even when they are permitted to do so, they will be only too prone to be overcautious. The only sound standard in a vast and technically complex government such as ours is to insist that the public statements of officials be in keeping with the highest requirements of scientific work. If a man's superiors disagree with him, let them mount the same rostrum and prove that he is wrong; before the goddess of science all men are equal. Without this conviction the present volume could not have been conceived. In its pages men of science inside and outside the government service match their views and findings in a common effort to reach the right conclusions.

CONCLUSION

The ways, then, by which a measure of genuine responsibility can be secured under modern conditions appear to be manifold, and they must all be utilized for achieving the best effect. No mere reliance upon some one traditional device, like the dependence of the Cabinet upon majority support in Parliament, or popular election of the chief executive (neither of which exists in Switzerland), can be accepted as satisfactory evidence. At best, responsibility in a democracy will remain fragmentary because of the indistinct voice of the principal whose agents the officials are supposed to be — the vast heterogeneous masses composing the people. Even the greatest faith in the common man (and I am prepared to carry this very far) cannot any longer justify a simple acceptance of the mythology of "the will of the people." Still, if all the different devices are kept operative and new ones developed as opportunity offers, democratic government by pooling many different interests and points of view continues to provide the nearest approximation to a policy-making process which will give the "right" results. Right policies are policies which seem right to the community at large and at the same time do not violate "objective" scientific standards. Only thus can public policy contribute to what the people consider their happiness.

PRICE POLICIES AND FULL EMPLOYMENT*

Edward S. Mason

PROBLEMS FACING THE TEMPORARY NATIONAL ECONOMIC COMMITTEE

THE circumstances leading to the creation of the Temporary National Economic Committee (the so-called Monopoly Investigation) heavily emphasized the relation of business price policies to the functioning of the economic system. The Congressional resolution creating the Committee was formulated in the midst of the business recession which became evident in the fall of 1937. Political exigencies created by the attempt of anti-administration forces to exploit this situation to their advantage, by variations on the theme of a "Roosevelt Recession," led to a counterattack on the policies of "big business." In the phraseology then current "big business" had "priced itself out of recovery."

The opportunity to direct attention to the economic consequences of business price policies was welcomed by a number of government agencies concerned with this problem. The Antitrust Division of the Department of Justice, under the leadership of Robert Jackson, had for some time laid emphasis — reiterated in the report of the Department for 1937 — on the importance of considering the *consequences* of business policies rather than the *intentions* behind these policies in the enforcement of the antitrust acts. Certain circles at the Federal Reserve Board were inclined to attribute to the rapid rise in the prices of a number of industrial products an important role in cutting short the recovery of 1934 to 1937. In the Department of Agriculture the relative inflexibility of industrial prices during the downturn from prosperity to depression had become the cornerstone of what amounted to a theory of the business cycle.

During the winter of 1937–38 a "business price-policy" theory of the recession was proclaimed by a number of administration spokesmen, notably Messrs. Ickes and Jackson. In February

* Sections I and II of this paper form a part of an interim report made to the Bureau of Labor Statistics in connection with the Bureau's work for the T.N.E.C.

1938 a Committee on Price Policy appointed by the President called attention to the fact that "the prices of some items are still at the highest levels reached in 1937; some are even higher than in 1929."

The Committee further observed,

> When high prices sharply curtail sales there is a real danger. This is shown by our recent experience with housing. A year ago there was a serious shortage. We had unused productive resources ample to overcome the shortage. Yet all the major elements in housing costs advanced so sharply by the spring of 1937 as to kill a promising expansion of activity in an industry whose restoration is vital to continued recovery.

These views regarding the relation of price policy and price behavior to the functioning of the economy were underlined in the President's "Message on Monopolies" of April 29, 1938.[1] As a formulation of monopoly problems the President's message was novel in at least two respects: (1) in its emphasis on a "concentration of economic control" which influences in many ways the activities of business firms; and (2) in its emphasis on the relation of price policies and price behavior to fluctuations in employment and volumes of output.

With respect to the latter, the message summarizes a number of observations on this relationship in the statement,

> One of the primary causes of our present difficulties lies in the disappearance of price competition in many industrial fields, particularly in basic manufacture where concentrated economic power is most evident — and where rigid prices and fluctuating payrolls are general.

Reflecting this emphasis on business price policies, the Congressional resolution creating the Temporary National Economic Committee enjoined the Committee with the duty of investigating "the matters referred to in the President's Message," including "the effect of the existing price system and the price policies of industry upon the general level of trade, upon employment, upon long-term profits, and upon consumption."[2]

It must be recognized that, in technical economic literature, problems concerning the relation of price behavior to the full and efficient use of economic resources are in a somewhat anomalous

[1] 75th Congress, 3rd Session, Senate Doc. no. 173. Message from the President of the United States transmitting recommendations relative to the strengthening and enforcement of the antitrust laws. April 20 (calendar day, April 29), 1938.

[2] Public Resolution no. 113, 75th Congress, June 16, 1938.

position. During the nineteenth century — and in fact until fairly recently — it was widely accepted, in accordance with Says's law, that both the long-run allocation and organization of economic resources and the short-run adjustments necessary to reëstablish a full employment, temporarily disturbed, are — and should be — accomplished by the type of price changes which are "automatic" in freely competitive markets. An increased awareness of the extent of business price controls, together with a more intensive examination of price behavior, has made it clear that price adjustments are not as "automatic" as had been supposed. At the same time post-war business cycle theory, with its emphasis on fluctuations in the volume of investment, has directed attention away from price adjustment as the central aspect of the problem of maintaining or restoring full employment.

While it is recognized that the way prices behave on the downturn and upturn may have "something to do" with the extent of depression or the character of the recovery, many proposals for public action designed to promote economic stability and reëmployment are apt to assume price behavior as given. In part this minimizing of price problems is probably the result of the very great difficulty of distinguishing between price behavior which promotes and that which retards recovery and full employment; in part, no doubt, to a reasonable suspicion that even though this distinction were made not much could be done about it.

This paper is not primarily concerned with the relative importance of a public policy with respect to prices as against other forms which public action might take to promote full employment. Nor is it concerned with the various possible techniques of public action considered elsewhere in this volume by Mr. A. H. Feller. Section I attempts to make clear why business price policies are of public concern. Section II attempts to formulate some of the public policy issues in the field of prices which are relevant to the work of the Temporary National Economic Committee.

I

PUBLIC CONCERN WITH BUSINESS PRICE POLICIES

The price system — or cost-price structure — composed of all the prices of individual commodities and services offered for sale, may be regarded as an elaborate indicator of the economic alterna-

tives open to producers and consumers. To the consumer the structure of prices indicates the terms on which he can acquire the goods for which he spends his money income. To the producer the structure of prices indicates the terms on which he may dispose of his goods and services or acquire the goods and services of others. Any change in this price structure involves a change in the alternatives open to some or all producers and consumers. Since the price system defines, in important respects, the conditions on which producers and consumers engage in economic activity, it influences, on the one hand, the efficiency with which economic resources are used to satisfy human wants and, on the other, the size of the income streams which flow to those who, as owners or workers, participate in the process of production.

In an economic system in which no single buyer or seller was able to influence the price of the goods and services bought or sold, the structure of prices would more effectively determine the economic action of producers and consumers than, in fact, it does today. Such a situation substantially exists, for sellers, in the markets for the principal agricultural crops and, for buyers, in the principal consumers' goods markets. The individual farmer, not being able to influence the price of the produce he sells, determines what crops he will produce and what acreage he will sow in view of the *existing or expected price situation.* As a result of the action of hundreds of thousands of independent farmers (together with other influences which lie outside their control) the price structure of agricultural prices changes in ways which may influence the kinds and quantities of farm products produced in the next crop period. The structure of prices thus influences the action of individual farmers, but the action of individual farmers does not in any significant degree influence the structure of prices.

Likewise, the individual housewife governs her purchases with reference to the existing structure of prices in the consumers' goods markets. If the price of beef is high, she may switch to pork; if citrus fruits are cheap, she may introduce grapefruit to the breakfast table. As a result of the action of millions of housewives the structure of consumers' goods prices changes, and in consequence of these changes individual housewives alter their buying practices. Again the structure of prices influences the actions of the individual purchaser, but the action of the individual purchaser does not influence the structure of prices.

If all markets were organized, on both the buying and selling

side, in such a fashion that no individual buyers or sellers could influence the price, then all producers and consumers would be constrained to seek their economic advantages under the conditions laid down by the existing or expected price structure rather than by attempting to change or to maintain prices. No firm or group could have a price policy any more than a farmer or housewife can have a price policy.

The principal problems faced by the Committee in the price area arise because in fact, particularly in the industrial sector of the economy, buyers and sellers can and do influence price. The buyers in the raw tobacco market are so large and so few in number that the purchases of any one of the principal companies necessarily influence the price producers secure for their crop. In the market for many heavy steel products the position of the United States Steel Corporation is so dominant that its action cannot fail to be important in the determination of prices. For many consumers' goods, firms can, through heavy selling expenditures, influence consumers' choices and consequently the prices that are charged for the product.

The control of buyers or sellers over prices can be and is accentuated by collusive action, by trade association practices, and by pricing techniques. The important fact, however, is that, given the ability to influence price, buyers and sellers can have a policy with respect to price — they can raise or lower prices or keep them stable even though external conditions change somewhat. The price policy followed will influence the behavior and structure of prices, and the structure of prices will have consequences for the functioning of the economy. The situation in most industrial markets is not one in which firms are limited, in pursuit of their economic advantage, to the production and distribution of goods under conditions determined for them by an existing cost-price structure. The possibility is also open to them to influence, to their advantage, the terms on which they buy and sell.

This does not mean that a buyer or seller can completely determine the price at which he buys or sells. No firm, no matter how strong its market position, can determine the price of its products without any regard for whatever competitive situation exists. The Aluminum Company of America, which produces 100 per cent of the virgin ingot aluminum made in this country, is forced to take account in its price policy of the competition of scrap aluminum, imports of virgin ingot, iron and steel, and nonferrous

metal substitutes. Any business man, as a matter of fact, is so acutely aware of the competitive elements in his market that he is prone to ignore, or even deny, the existence of any control over price. We are presented, in consequence, with the spectacle of the representatives of industries in which concentration is very marked, asserting — and believing — that the prices of their products are determined by the impersonal forces of supply and demand.

Although all firms operate in markets in which they meet the competition of rival producers and rival products, there is for most firms an area of control within which the formulation of a price policy is possible. Certain competitive and collusive tactics, furthermore, have the effect of widening this area. The wider (or more expansible) the area, the greater may be the incentive to pursue profits by other means than by increased production and distribution of goods.

The types of price policy which may be used to widen or exploit market control positions are as numerous as the types of market situations which firms confront. Faced during a business recession with a demand temporarily inelastic, a firm may decide on a policy of price maintenance. To increase sales might require a sharp reduction in price, to the disadvantage of the firm in question. To be able to influence price by increasing or decreasing sales indicates a control position for the firm. The decision to maintain price is a policy decision designed to take advantage of this control position. Other sorts of price-policy decisions are evident in the classification of customers for the purpose of charging different prices to different groups, selling only at delivered prices, following the price leadership of a particular firm. All are dependent on the existence of some degree of price control.

It does not follow that, just because the market position of buyers or sellers permits the determination of price policy, this policy necessarily runs counter to the public interest. Still less does it follow that public action should be taken to eliminate the possibility of price control on the part of buyers or sellers. Such action would probably involve a breaking-up of concerns (an atomizing of competition) on a scale undreamed of by even the most enthusiastic of trust-busters. On the other hand, it *does* follow that in those areas in which firms are able definitely to influence price, price policy becomes a matter of public concern.

The structure and behavior of prices impose a set of conditions which seriously influences the functioning of the economic system. The structure and behavior of prices, at least in the industrial sector, is largely the result of price-policy decisions.

THE LACK OF STANDARDS OF UNDESIRABLE PRICE BEHAVIOR

The case for public concern with price polices and price behavior can be outlined in the following propositions:

(1) The behavior of prices has an important influence on the functioning of the economy.

(2) Certain types of price behavior are more conducive than others to full employment and the efficient use of economic resources.

(3) It is possible, at least in part, to discover which types of price behavior encourage and which handicap the fuller attainment of these objectives.

(4) It is possible, at least in part, to facilitate by public action price behavior which encourages, and to prevent price behavior which handicaps, the attainment of these objectives.

With respect to this case, it may be observed that propositions (1) and (2) would receive general, even universal, acceptance. However, when the argument proceeds from a general indictment of "undesirable" price behavior to a specification of what types of price policy and price behavior are undesirable — and why — agreement is by no means general. The truth of this statement is easily demonstrated. The basing-point system of price quoting as practiced in steel, cement, and other industries has been the subject of active investigation and discussion by government and private experts for at least fifteen years. Whether this system produces results much less desirable than the results of any probable or attainable alternative method of price determination is still a matter of acute controversy.

The relative inflexibility of industrial prices during a downturn of business activity, to take another example, has been demonstrated beyond the possibility of doubt. Moreover, there would probably be general agreement to the proposition that a greater responsiveness of some prices to a decline in costs and volume of sales would contribute to the stability of employment and output. But when it comes to a specification of what prices should decline, in what manner, by how much, and within what limits appropriate

government action can be expected to accomplish this result, the record is relatively blank.

Until recently public policy in this country has not been concerned with non-predatory price policies of independent firms outside the public utility field. The antitrust acts have been enforced against agreements destroying the independence of firms in the field of price and other policies. They have also been enforced against price policies — particularly price discrimination — designed to drive rivals from the field or to prevent the entry of potential competitors. With respect, however, to price policies independently determined within the framework of the existing structure of industrial markets the administration of the antitrust acts has been conspicuously silent.

Recent legislation has set off certain areas within which price policies and price behavior have been recognized as the concern of public policy. The NRA offered a striking, though temporary, example. Of more permanent significance has been government action with respect to agricultural commodities, coal, oil, and sugar. It is interesting to note that public policy in these areas has induced price increases either by means of or accompanied by restriction of output. Presumably the problem primarily presented in other economic areas is not one to be met by facilitating restriction of output and price increases but rather the reverse. Consequently, recent legislation does not throw much light on the question of devising tests of desirable and undesirable price behavior encountered in the industrial sector.

The President's message on monopolies offers the suggestion that certain techniques of price-making or types of price behavior might be accepted as prima facie evidence of violation of the antitrust acts. The implementing of this suggestion either by means of additional legislation or reinterpretation of the antitrust acts would definitely represent a change of public action in the field of business price policies. The extent of this change, however, would vary markedly, depending on which one of two quite different meanings is implied. Certain pricing techniques or types of price behavior might be accepted as prima facie evidence of collusion or lack of independence on the part of buyers or sellers. The existence of identical bids, rotating bids, basing-point practices, and others may serve as examples. If these and other pricing techniques are to be accepted as prima facie evidence of an absence of free competition or of independent competitive action, the scope

of the antitrust acts is, to be sure, extended. But the extension is along traditional lines as respects both the nature of the evil to be corrected and the remedies to be applied. The evil is still conceived to be an interference with the independence of rivals in what would otherwise be a more freely competitive market. The remedies would still consist in eliminating the interfering practice, thus restoring the independence of rival firms.

Another interpretation, however, is possible. Among the examples of undesirable price behavior cited in the President's message is price inflexibility or rigidity. While price stabilization and other questionable policies *may* be the result of practices which fall within the existing — or an expanded — meaning of the antitrust acts, this is by no means necessarily so. In markets in which firms enjoy some degree of price control — and this embraces practically all markets outside of the agricultural sector — price stabilization and other questionable policies may represent merely the attempt of independent firms to pursue their advantage within the existing framework of the market. In such a situation price becomes a matter of policy. Instead of pursuing economic advantage within the limits of an existing price system firms are typically in a position to influence directly — or indirectly through various forms of non-price competition — the price of the product they buy and sell.

If, now, price behavior is to become the concern of public policy directly, rather than merely as evidence of the existence of practices violative of the antitrust acts, as traditionally interpreted, either tests of desirable (or undesirable) types of price behavior or price policy of a somewhat novel sort will have to be devised. Neither the evils to be remedied nor the remedies to be applied fall completely within that conception of the monopoly problem embraced by the antitrust acts.

Section II of this paper presents an attempt to analyze public policy issues in the field of prices. It should be emphasized at this point that a useful examination of the desirability or undesirability of particular types of price behavior or policies cannot proceed by means of a study of prices alone. A consideration merely of differences in the behavior of a large number of price series over a period of time reveals little data of use either for the diagnosis of economic ills or for public policy prescription. In the first place, price, as a sum of money changing hands in con-

nection with a purchase or sale, is only one of many items indicative of the terms on which the buyer acquires or the seller releases the commodity in question. Competition in the markets for fabricated products exhibits a continually increasing emphasis on non-price forms. Discounts, free deals, product changes, selling outlays not only change the inducements to purchase and sell but affect, in many cases drastically, the terms on which commodities change hands. An analysis of price behavior which took no account of changes in non-price terms of purchase and sale would, in the case of many products, be of questionable utility.

Secondly, even if all non-price terms could be reduced to price terms — which for many products is impossible — a study of price behavior alone would be unlikely to yield results of value for policy formation. The determination of price takes place within the limits of forces which lie outside the price-maker's control. An increase in wage rates or the price of materials imposes certain conditions on a seller which must be taken into account in the pricing of his product. A judgment on his price policy, therefore, cannot be formulated without an understanding of the limitations, and changes in the limitations, within which he operates. A price, for example, which is insensitive by any of the current measures of prices change, may be sensitive with respect to changes in the conditions which a business man must take into account. In other words, the formulation of an opinion on the relative desirability of a specific example of price behavior requires an intensive examination of costs, demand, and other conditions in the market.

A consideration of the forces lying outside a price-maker's control impels a final cautionary observation. This paper deals primarily with business price policies as reflected mainly in the movements of prices at wholesale. These data, needless to say, form only a part of the total cost-price structure. Another important part of that structure is made up of the prices of services, particularly wage rates. It is not a function of this paper to deal with the consequences of the behavior of wage rates for the functioning of the economy. It is perhaps unnecessary to emphasize that these consequences may be important. A change in wage rates involves a change in the cost conditions under which firms operate which almost necessarily produces a change in the prices of products. In 1937–38, to take an example, the prices of a number of agricultural implements increased to a level considerably above the prices for these articles in 1929. A judgment, however,

as to the desirability or undesirability of these price changes is impossible without a consideration of the fact that hourly wage rates in this industry increased to from 25 to 50 per cent above their 1929 level.

To an examination of the possible consequences of price policies and price behavior for the functioning of the economy we now turn.

II

ISSUES IN THE FIELD OF PRICE POLICIES

The price policies of business firms influence in important ways the structure and behavior of prices. The structure and behavior of prices in turn have serious consequences for the functioning of the economy. The purpose of this section is twofold: on the one hand, to indicate the broad issues in the area of the relation of price behavior to the functioning of the economy, and, on the other, to focus attention on certain problems in this area which appear amenable to investigation.

The joint resolution creating the Temporary National Economic Committee defines in a general way the scope of the problem. The Committee is to investigate "the effect of the existing price system and the price policies of industry upon the general level of trade, upon employment, upon long term profits, and upon consumption." These agenda may be conveniently grouped, for purposes of discussion, into the effects of the existing price system and price policies upon (1) efficiency in the use of economic resources and (2) the distribution of the national income among the various participants in the process of production. A consideration of price policies in relation to the "general level of trade" and "employment" emphasizes the existence of recurring or continuing unemployment of labor and capital which is an important manifestation of inefficiency in the use of resources. The effects of the price system and price policies on profits is a part of the consequences of this system and these policies for the distribution of income. Their effects upon consumption are in part to be discovered by way of an examination of the distribution of the national income, in part through a consideration of other aspects of the problem of efficiency. This section is limited to a consideration of some aspects of the relation of price policies to economic efficiency.

PRICES AND EFFICIENCY

The term "efficiency" in general implies a skillful use of given means to achieve given ends. In the economic area the means are the available supplies of human abilities, the material, and the natural resources seeking employment. The end is the greatest possible satisfaction of human wants for the products and services which can be produced by these resources within the general limitations imposed by existing social and economic institutions. An approximation to this objective requires a fairly continuous, full employment of the available resources in ways which yield high productivity. Granted that the productivity of resources already employed is not adversely affected thereby, any policy which puts to work unemployed resources increases the efficiency of the economic system as a whole. Granted further that total employment is not adversely affected, any policy which facilitates a transfer of resources from less to more productive uses increases efficiency. This distinction between the productivity associated with a given rate of employment and fluctuations in this rate suggests that the problems revolving around the relation of price policies and price behavior to efficiency may well be divided into two groups.

One group of problems is concerned with distribution of resources as between different uses, different types and sizes of business organization, different geographical locations, and different techniques of production and marketing. The existing structure of prices influences this distribution of resources; changes in price relationships, affecting volumes of output and the disposal of new investment, slowly change the distribution of resources. Certain price policies and types of price behavior are more conducive to an efficient distribution and use of a given volume of employment of human and material resources than others. However, in the main, these policies can work out their effects only through a long-run adjustment of capital investment and a relocation of labor and material resources.

The second group of problems is concerned with changes in the rate of employment. A somewhat regular fluctuation in the rate of employment is an important characteristic of the business cycle. There is some reason for believing that certain price policies and types of price behavior are less conducive to a rapid and serious decline in the rate of employment of men and materials than others. On the other hand, it is fairly clear that the behavior

of prices on the upturn has a good deal to do with whether or not a recovery will be sustained. The relation of price behavior to the rate of use of resources, however, is by no means entirely a problem of the business cycle. Events of the last decade have emphasized the possibility that serious unemployment of resources may be continuous. One of the important issues to be investigated, therefore, is the possibility of stimulating the reemployment of idle resources through a change in price policies. In fact, in the contemporary setting, this may be said to be the crucial issue.

This distinction between the effect of price policies and price behavior on the long-term distribution and organization of resources and the effect on changes in the rate of employment of existing resources is not a mutually exclusive distinction. Public action designed to influence the distribution and organization of resources would have repercussions on the rate of use. On the other hand, an attempt to increase the rate of use of resources by almost any feasible policy would have repercussions on their distribution and organization. Nevertheless, this distinction is necessary and useful in order to bring into focus the primary issues in the field of price policy.

The basing-point system of price quoting, for example, which has existed, in various forms, for a long time in the steel industry has influenced the location of basic production as well as fabricating and finishing plants. It is alleged that the present locations are not the most economical and that, furthermore, the continued existence of the basing-point system encourages a wasteful cross-hauling of products. A public policy designed to correct these alleged evils by changing the methods of pricing could only accomplish its objective through a slow adaptation of the location and organization of resources to the changed pricing system. There would undoubtedly be repercussions on the rate of utilization of equipment and man power in the steel industry. While these probabilities would have to be taken into account in the formulation of a public policy regarding the basing-point system, the main considerations have to do with long-term efficiency in organization and location.

One of the questions, to take another example, which excited controversy following the business downturn in 1937 was whether the prices of certain products, particularly construction materials, had not increased so rapidly in 1936 and 1937 as to handicap a

sustained recovery. Assuming that these price increases were recognized at the time as undesirable and justifying public action, the considerations mainly involved would have to do with the possibility of stimulating by such action a continued increase in the rate of use of resources. Very possibly the appropriate policy would have long-term repercussions on the distribution of investment and the organization of resources in certain areas. These repercussions would be secondary, however, to the main considerations in question.

This distinction between the consequences of price policies and price behavior for the allocation, as against the rate of use, of resources is advisable not only because the economic issues in the two types of questions are somewhat different, but also because it is probable that the public action appropriate to dealing with these questions would be different.

Economic research has emphasized chiefly two aspects of the relation of price policies to long-term efficiency. The first has been concerned with the effects of price policy and price behavior on the allocation of economic resources, i.e., the problem of over- and underinvestment; the second with the supposed waste of resources in various forms of non-price competition.

The first problem is the monopoly problem as traditionally conceived. The possession of a considerable degree of market control has been understood to permit a seller to charge a price higher than would be charged by the sellers of the same product were the market more competitive. The high price restricts the volume of sales and output, and consequently the employment of resources necessary to the production of the required volume. The unutilized resources are forced to seek employment elsewhere, with the result that overinvestment develops in the more competitive sectors of the economy. It is argued that a transfer of resources from the areas of overinvestment to the areas of underinvestment would permit a substantial increase in the national income.

The validity of this argument does not depend on the assumption that economic resources are fully employed. A transfer from less productive to more productive uses would increase the national income produced at any given level of employment. Nevertheless, if there are large amounts of unemployed resources any transfer difficulties which may be involved are probably accentuated in importance. To restrict output in the bituminous coal industry, for example, in the face of a considerable volume of

unemployment elsewhere is probably a more serious step than it would be if employment were relatively full.

There can be little doubt, though the evidence is scattered and difficult to interpret, that existing over- and underinvestment has serious consequences for long-run efficiency in the use of resources. For example, if a given level of employment could be maintained, there is every reason to believe that a transfer of resources from some branches of agriculture, the bituminous coal industry, and some branches of the cotton textile industry to certain industrial sectors of the economy would increase the national income. In order to maintain this level of employment, however, the long-run price policies in these industrial sectors would have to be modified to permit an increase in sales and volumes of output. Just what these industrial sectors are and what modification of price policies would be necessary are precisely the problems, related to long-run efficiency, which have to be solved.

A comprehensive solution to the first problem would obviously require some measure of desirable investments by means of which to test the extent of over- or underinvestment in different economic uses. While the formal requirements of a desirable amount of investment can be approximately stated, no tests which are entirely satisfactory and applicable to particular situations, given the available data, have been devised. In the absence of such tests public policy is apt to resort to evidence which is fragmentary and unsatisfactory.

In the economic sectors alleged to be characterized by overinvestment the evidence usually adduced is of low prices, rapid turnover of firms, low profits and wages, the existence of unutilized capacity, and "market demoralization." In the economic sectors in which underinvestment is considered to exist, the evidence presented is of high prices, prices which fail to fall with technological improvements, high profits and returns to labor, and comparatively full utilization of capacity. Outside the public utility field direct price or output regulation has been applied in this country only to the overinvestment areas. The Bituminous Coal Act and the Agricultural Marketing Agreements Act provide for minimum prices for coal and milk. The Sugar Act and the Agricultural Adjustment Act attempt control of output.

It is obvious that public intervention in these areas is likely to be politically much more feasible than in the underinvestment,

restricted output areas. Producers will accept — and frequently demand — public action designed to restrict output and raise prices, whereas action designed to expand output and investment and to reduce prices may be bitterly opposed by the interests affected. Although a good case can be made out for the restriction of output in these and other areas and the transfer of resources elsewhere, this case depends on (1) a definite limitation of the economic sector to which these remedies are applied, and (2) the adoption of policies designed to promote expansion and reëmployment elsewhere in the economic system. The standards of proper prices and output written into recent legislation certainly do not provide tests the application of which would be likely to limit restrictive policies to a small sector of the economy. Both the "parity price" of the Agricultural Adjustment and Agricultural Marketing Agreements Acts and the "average cost of production" of the Bituminous Coal Act, if applied throughout the economic system, would imply a wide expansion of restrictionist policies. One of the serious issues confronting public policy in the price field would seem to be the formulation of tests of "excessive" or "ruinous" or "cutthroat" competition sufficient to indicate the desirability of restricting output and diverting resources into other channels. The existence of prices lower than "parity prices" or than prices covering "average cost of production" provides no such test.

In the second place, restrictionist policies have not hitherto been accompanied by price and output policies designed to encourage expansion in the underinvestment sectors of the economy. Yet this is the crucial aspect, for public policy, of the relation of price policies and price behavior to long-term efficiency. To deal with this problem effectively would require tests indicative of the existence of price policies and price behavior unduly restrictive of output and investment. The tests currently applied are fragmentary and almost wholly inadequate. The Federal Trade Commission, for example, cites as partial evidence of unduly restrictive price policies the fact that the prices of certain agricultural implements did not fall as much as (or rise more than) the prices of "implements somewhat comparable to farm implements in materials and labor" in the period 1929 to 1937. The articles with which agricultural implements are compared are four-door sedan automobiles, one and a half ton trucks, gas ranges, electrical refrigerators, ice refrigerators, warm-air furnaces, and hot-water

boilers. While such a comparison may suggest the necessity of further investigation into the reason for the differences in the price behavior of these articles, it can hardly be accepted of itself — nor would the Commission so claim — as evidence of undesirable price behavior.

The existence of high profits over a long period of time in an industry which is not growing rapidly may be indicative of underinvestment. On the other hand, in a rapidly expanding industry such as rayon the persistence of high profits may simply reflect a necessary and unavoidable lag of productive facilities behind an even more rapidly expanding demand. A study of profit records can provide necessary but not sufficient evidence of the existence of output and investment restriction. An examination of the degree of utilization of installed capacity may produce further relevant data. If public action in this area is contemplated, however, more comprehensive data is required. It is also clear that the formulation of satisfactory tests of restrictive price policies would necessitate a more thoroughgoing comparison of cost-price relationships in different industrial markets than any hitherto undertaken.

While the relation of price policies and price behavior to the over- and underinvestment of economic resources presents a serious problem, it appears unlikely that further price research will lead to immediately practical results. This does not mean that such research is useless. On the contrary, a careful investigation of the relationships of costs, prices, output, and investment in different types of industrial markets can probably contribute substantially to an understanding of the consequences of business policies for the long-term distribution of resources. But this is definitely long-term research. It is possible that effort expanded elsewhere will yield results of more immediate utility.

Before turning to these problems it is necessary to call attention to the fact that the relation of price policies to long-term efficiency embraces other questions than the under- and overinvestment of resources. Price policies reflect, and in turn influence, the organization of resources within, as well as their distribution among, different uses. Price discrimination, for example, may affect the size of buying as well as selling firms, the location of fabricating plants, and the expansion of particular kinds of distributive channels. These consequences all involve questions of long-run efficiency. Certain of these questions, such

as the economic consequences of basing-point systems and of price discrimination in favor of mass distribution are in the forefront of public discussion. Here again, however, the formulation of applicable tests of what are optimum sizes of business firms, optimum locations for productive capacity, and optimum distributive channels has lagged behind the recognition of the importance of these problems.

Of more immediate importance would appear to be an examination of the possibility of further expansion of output and employment in particular industries. Such an examination is concerned with price policy only in the broadest sense. Expansion of output may require a redesigning of products, the use of different distributive channels, coöperation among producers in different industries, or a change in any of the other terms on which buyers are offered commodities or services.

In a period of full employment the expansion of a particular industry or group of industries would presumably involve a transfer of resources employed elsewhere. Whether or not such a transfer would be desirable would depend on considerations of over- and underinvestment and other aspects of long-term efficiency discussed above. In a period, however, of widespread and continuous unemployment an expansion of particular industries *may* make possible a net increase in employment with or without a considerable transfer of resources already employed. A consideration, therefore, of these possibilities would appear to offer one of the most immediately practicable opportunities to make a contribution to public policy in the field of price research.

At the present time it is generally recognized that an important factor contributing to continued unemployment is the extremely low volume of new investment. To some, the remedy appears to be government borrowing and spending to absorb the funds which, under other circumstances, have flowed through the channels of private investment. Others look for new industries to open up these channels. There is, however, no particular virtue in the newness of an industry. A continued expansion of already existing industries may serve the purpose of inducing investment and increasing employment. To encourage expansion, however, may require a change in price policies. To establish the character of the required change is, therefore, the problem.

There are certain fields in which investigation appears to promise better results than in others. One of these fields embraces

a group of consumers' durable goods industries which have provided large and, until recently, increasing opportunities for investment and employment. These industries, in their process of development, exhibit striking similarities. A period of rapid expansion of output accompanied by product improvement and price reduction has been followed by a flattening of the growth curve. For many of these industries the demand has become almost entirely a replacement demand and, since replacement may be postponed, an exceedingly fluctuating one. While, for certain of the products involved, families in the upper income levels are almost completely equipped, this becomes progressively less true in the lower income groups. Obviously, if these industries are to enjoy an additional period of expansion, ways must be found to carry sales into the lower income groups.

For some of these products, notably electrical equipment, the relevant price is the price per unit of service, which is affected not only by the price at installation but by the durability of the product, the cost of servicing, and the price of electric current. For others the relevant price is the difference between the price of a new article and the turn-in value of a used one, and conditions in the secondhand market clearly have repercussions on the volume of sales of new products. For others a continued expansion in sales may involve a redesigning of the product to meet new needs, the provision of adequate consumer financing, or the exploration of new channels of distribution. A thoroughgoing examination of the possibilities of continued expansion for this group of industries may make an important contribution to employment.

A second fruitful field of investigation seems to be indicated by recent experience in the field of electric power consumption. Some evidence, particularly in the Tennessee Valley area, suggests that electrical companies habitually underestimate the elasticity of the demand for their product in domestic consumption. In those cases in which a substantial rate reduction would lead to so large an increase in sales as to increase — or at least not substantially reduce — net revenue, such a reduction is clearly desirable. An expansion of output and, subsequently, of investment in this important industry may make possible a substantial increase in employment. The whole field of public utility industries is peculiarly adapted to studies of demand elasticity both by reason of the fact that the product sold is a relatively standard unit of

service and because the areas of sale for individual producers are isolated. The existence of public regulation in this field, furthermore, makes it easier than elsewhere to put the results of such investigations into practice.

A third field of investigation is presented by the construction industries. The demand for construction represents a joint demand for a wide variety of materials and labor and contracting services. A substantial reduction in the prices of particular materials or labor services involves a relatively small reduction, at best, in the cost of construction. It is therefore not within the power of suppliers of particular materials or services to stimulate the demand for construction even by drastic price reductions. By reason of the complementary character of materials and services, these suppliers are faced with demands which are highly inelastic. The inelasticity, however, is in large part the result of the way economic resources are organized in this branch of industry. A substantial change in the organization might produce substantially different results. The extent to which certain fabricators of construction materials are experimenting in the field of construction indicates some of the possibilities. A study of the probable effects of simultaneous changes in materials prices and wage rates on the cost of construction is clearly a fruitful field of price research. It may serve to indicate those areas in which price reductions are likely to prove of greatest assistance in stimulating expansion in the construction industries.

The examples just cited are representative of a type of problem to which it is believed price research, broadly understood, can make a practical contribution. A change in price policies in these or other industries leading to an expansion of sales and output could, under certain circumstances, induce a substantial net increase in employment. An increase in output of a particular product, not accompanied by an increase in investment, and leading merely to a diversion of consumer spending from other products to the one in question, would not, of course, be likely to produce such a result. The volume of consumer spending involved in questions of this sort cannot be accepted, however, as fixed. A change in the terms on which a product is offered may lead to an increase in consumer spending, and, if the increase in output produces an increase in net investment, it will lead to an increase in consumer incomes.

A concentration of attention on the possibilities of output ex-

pansion through a change in pricing or market policies does not mean that other aspects of the relation of price policy and price behavior to long-run efficiency should be neglected. It has always been recognized, considering the structure of prices as a whole, including the prices of labor and other factors of production, that appropriate price adjustments may increase employment and promote a more efficient utilization of economic resources. Price research has not been particularly successful to date in suggesting standards of appropriate price adjustment. There are, furthermore, political and economic obstacles to some types of price adjustment which may make the application of such standards impracticable. Nevertheless there clearly remains an important area within which price research may make an effective contribution to a public policy.

NON-PRICE COMPETITION

A second broad aspect of the relation of price policies and price behavior to long-term efficiency on which attention has traditionally centered has to do with the increasingly important phenomena of non-price competition. Business firms not only pursue their advantage by adjusting prices to the existing market situation; they also attempt to increase their sales and improve their position in the market by changing their products, their location, by advertising and selling expenditures, and in other ways. The whole group of business policies designed to increase the sales of a firm within a given price range may be roughly designated non-price competition. It is clear not only that the character and importance of non-price competition affects the significance of price as an expression of the conditions on which sellers dispose of and buyers acquire products but also that the price policies of a firm are only a part, and are closely influenced by other aspects, of the firm's sales policy.

Certain types of non-price competition are presumably desirable; others are, prima facie, wasteful. To the extent that waste may be involved, it is not usually the result of restrictionist policies designed to exploit an existing market control position. On the contrary, the fields in which the prima facie case for the existence of wasteful non-price competition is strongest are frequently industries and markets in which the competing firms are small and the rivalry between them intense. This rivalry, however, may involve large expenditures in ways that make no com-

mensurate contribution to the satisfaction of consumers' wants. Large expenditures, for example, on the advertisement of various cosmetic and drug preparations may represent a very considerable waste of resources.

Non-price competition offers means by which a seller can augment his price control and lessen the rigor of direct price competition. He accomplishes this objective by differentiating his product from that of his immediate rivals. In a market for a graded product, such as No. 2 northern wheat, where the units offered for sale by one seller are perfectly substitutable for those of another, such competition for business as exists must take the form of direct price competition. If it were possible for a seller to offer a superior quality of wheat, or to convince buyers that his product was superior, he would be in position to command a price differential and to influence the size of that differential by varying the quantity of his product offered for sale. This is substantially what happens in markets for other than graded products.

With respect to the *seller's* interest, it makes no difference whether price control is secured by means of a given expenditure on product improvement or by a similar expenditure devoted to persuading buyers that a nonexistent difference is real. Clearly, however, the bearing of these two types of expenditure on the *public* interest is different.

Whether sellers will resort to efficient or wasteful types of non-price competition will depend largely on the knowledge of the product possessed or obtainable by buyers. Business buyers are, in general, well informed and frequently buy only upon specification and testing. Consumers, on the other hand, in a wide variety of products are unable to form an accurate impression of relative merits and demerits. Consequently an important and observable difference exists between the methods of non-price competition in the producers' goods and in the consumers' goods areas. In the former area competition, in general, is on the basis of quality, accuracy of specification fulfillment, servicing, speed and assurance of delivery, and, of course, price. Advertising expenditures are usually relatively small, and selling activity is frequently associated with technical advice and servicing. In the latter field advertising expenditures are frequently considerable. Packaging and style factors are important, and brand names loom large. This does not mean, of course, that these types of non-price competition are necessarily wasteful.

The economic opportunities offered by various types of non-price competition may lead to the entry into different markets of large numbers of small high-cost firms, each owing its existence to its ability to attract a group of customers who prefer its product to the closely similar product of rival sellers. Small retail grocery stores scattered over an urban area may offer a trading convenience to the immediately surrounding public which permits them a higher price than that charged by their larger low-cost downtown competitors. The proliferation of gasoline stations seems to have been induced by consumers' preference for particular brands. While one station at a given street intersection might be operated more efficiently than the two or three or four among whom the business is actually divided, the competition between brand names encourages this division.

Although the possibilities of product differentiation may, in these and other cases, encourage the establishment of small high-cost firms, in other situations non-price competition may make the entry of new firms extremely difficult. For many products consumers are highly brand-conscious. A branded and nationally advertised product usually sells at a higher price than unbranded products of similar grade and quality. It is safe to say that in the cigarette and gasoline markets, for example, it is extremely difficult for a new firm to achieve consumer acceptance no matter what the quality of its product.

It is clear that if consumers were able accurately to judge the merits and serviceability of competing products, and utilized this knowledge in economically rational choices, price differences would more closely reflect quality differences than in fact they do. However, with the enormous increase in the number, variety, and importance of synthetic and highly fabricated products, for which the ingenuity of American enterprise has been responsible, an acquisition of the required degree of knowledge is difficult, if not impossible. Consumers' ignorance has opened up a wide field of economic opportunity for methods of non-price competition of dubious merit.

An attempt has been made to grapple with the problem of wasteful versus useful non-price competition by making a distinction between "rational" and "irrational" consumers' preference.

Irrationality . . . is to be detected by imagining that each consumer is forcibly removed from the firm with which he is accustomed to deal

to some other firm which meets the same want at a cost which, according to the general consensus of the market, is the same as that incurred hitherto. [The market organization] . . . is irrational to the extent that the consumer suffers no loss of satisfaction as a consequence of such diversion.

[The market organization] . . . is purely rational if it takes its basis in preferences which correspond to real satisfactions. Insofar as the forcible transfer of a consumer from one firm to another has no effect on his scale of preferences for the products of the different firms, the imperfection of the market may be said to be rational.[3]

While such a distinction may serve to clarify thought regarding the issue involved, it seems clear that it neither offers tests which can be applied directly nor suggests factual investigation likely to lead to the formulation of such tests. Investigation relevant to public policy in this area must take account of two aspects of the problem: (1) the relation of non-price competition to the behavior of prices, and (2) the effect of non-price competition on the costs of production of, and the quality changes in, the commodities in question. The first type of study is concerned with the effect of non-price competition (or some aspects of it) on the price terms on which buyers acquire goods. The second is concerned with the probable effects of the elimination of some kinds of non-price competition on the costs of producing these commodities.

A study of some aspects of the first question seems to show that for many consumers' products buyers are highly brand-conscious, and that the prices of a number of branded products respond less readily to cost reductions than the prices of similar, though unbranded, products. It is probably fair to conclude from this and other evidence that branding and advertising a product permits the seller to escape from some of the rigor of price competition. This type of study could be fruitfully pushed much further. An examination of the consequences of various types of non-price competition on the behavior of prices not only may illuminate the varying significance of price in different markets, as one of the conditions of sale, but it is also one essential avenue of approach to the problem of wasteful versus useful methods of competition.

The second type of study is more difficult but also more impor-

[3] R. F. Kahn, "Some Notes on Ideal Output," *Economic Journal*, March 1935, p. 26.

tant for the question at issue. On the condition that certain types of non-price competition were eliminated or regulated, what would be the probable effect on the cost of producing the commodity in question? How much, for example, would the elimination of contiguous gasoline stations and the consolidation of business in the hands of fewer units be likely to reduce the cost of distributing gasoline? The grading of gasoline would presumably reduce the importance of brands in determining consumers' preference and consequently the incentives of refiners and distributors to advertise and to place new service stations close to already existing stations. An estimate of the probable savings is relevant to public policy on the grading of this and other products. Equally relevant is the question whether such savings would be apt to be passed on in the form of lower prices to consumers.

What effects, to take another example, would a limitation on advertising expenditures in particular fields be likely to have on the volume of sales of the goods in question, the distribution of these sales between existing firms, and the costs to the sellers of producing and distributing the commodities? Such questions are extraordinarily difficult to answer, but they lie at the bottom of the question of the waste of economic resources in non-price competition.

PRICE BEHAVIOR IN RELATION TO EMPLOYMENT AND OUTPUT

Business price policies not only influence the direction of investment of fixed capital, the location of labor resources, and other aspects of the long-term pattern of industrial organization; price policies also presumably influence the rate of employment of labor and capital. Large and fairly regular fluctuations in the rate of employment are characteristic of the business cycle and an important aspect of the problem of economic efficiency.

Recent studies of cyclical price behavior have directed attention to price-stabilization policies as evidenced particularly by the relative inflexibility of industrial prices on the downturn. It is alleged that the failure of industrial prices to adjust to changes in material and labor costs and to changes in demand intensifies and prolongs depression and retards recovery. The role of price policies in the upswing is at least as important an aspect of the relation of price behavior to cyclical fluctuations in employment, although it has been relatively neglected. It should be noted in this connection that prices which are inflexible on the downturn

may be flexible on the upturn. The prices of a number of building materials, iron and steel products, and agricultural implements, to mention no others, moved downward very little between 1929 and 1932 but moved upward fairly freely in the period 1934–37.

The price data primarily utilized in studies of price inflexibility are commodity prices at wholesale. These prices form only one sector of a system of prices which includes wage rates, building and land rents, retail prices, public utility and railway rates, interest charges, and other prices. Obviously the effects on the rate of employment of greater or less flexibility of commodity prices will be different from the effects of greater or less flexibility in the price system as a whole.

In considering questions involving the influence of a continuing pattern of price relationships on the allocation and use of economic resources the repercussions of price changes on total money income and spending have been, and can be, neglected. These repercussions, however, become the center of the problem as soon as attention is directed to the relationship of price behavior to changes in employment and output in the economy as a whole. Most discussions of price policies in recession and recovery have neglected this fact. It has been too easily assumed that total money income is independent of a change in prices and wage rates, and that consequently any reduction in prices or wage rates will necessarily increase total employment, since it reduces the costs of some of the commodities or services for which this given money income is spent.

A recognition of the interdependence of prices, costs, and money incomes focuses attention on the necessity of examining the effect of given price changes on total money incomes and spending. A price reduction may increase total employment if it leads (1) to the spending of a larger share of existing money incomes. (2) to a transfer of income from income hoarders to income spenders, or (3) to an increase in money incomes through an increase in investment. If it leads merely to a transfer of a given volume of spending from certain commodities to others, it may produce no change in total employment, although a shift in spending from commodities produced at a low ratio of labor to total costs to commodities produced at a high ratio may increase the employment of labor at the expense of other factors.

If attention is focused on industrial price policies — i.e., on the behavior of the prices of manufactured products at wholesale — it must be recognized that the relative inflexibility of prices other than wholesale commodity prices constitutes, on the one hand, a limitation on the possibility of change in wholesale prices and, on the other, a limitation of the probable effect of increased price flexibility on the rate of employment and volume of output. Within these limitations the questions at issue are (1) what types of price policy and price behavior are likely to lessen the decline in rate of employment on the downturn from prosperity to depression, and (2) what types of price policy and price behavior are conducive to sustained recovery.

Contemporary discussion has defined the issue in this area as the consequences for output and employment of the relative inflexibility of industrial prices. The measures of price inflexibility which have been used are measures of frequency, amplitude, and timing of price change, and not of the responsiveness of price to changes in cost and demand conditions. Yet it must be admitted that it is the lack of responsiveness of price to changes in these conditions rather than "inflexibility" as such which has significance for the functioning of the economic system.

Mere measures of price change may nevertheless yield a roughly accurate indication of relative price responsiveness in a downturn from prosperity to depression, since in such a period nearly all commodities are subject to the same sort of change in cost and demand conditions. The wage rates and material costs relevant to the production of one commodity will fall by a smaller percentage than those relevant to the production of another, but they will fall for both. The demand for one product will decline further than another, but they will both decline. Under these circumstances a price which changes infrequently or by a small percentage or which turns down later is, prima facie, a price which is insensitive in the proper sense of the word. If it is inflexible by all these tests the case is strengthened. To proceed beyond this to a measurement of the relative responsiveness of prices would require an examination of the behavior of the material prices and wage rates relevant to the production of different commodities.

It would probably be wise, in such an examination, to distinguish between commodities with respect to which price inflexibility is accompanied by large expenditures on non-price competition and

those for which this is not true. The prices of many consumers' goods items — for example, wearing apparel sold at definite price lines — are inflexible, but producers compete avidly for business by product changes, changes in packaging, free deals, and in many other ways. The real problem of price inflexibility lies mainly in the field of producers' materials where fewness of sellers makes possible price stabilization policies unaccompanied by extensive non-price competition. In these fields a closer examination of the relation of material prices and wage rates to the price of the products will throw much needed light on the relative insensitivity of industrial prices.

Given the needed information on the relation of costs to prices, there remains a question that is central to public policy in this area: How sensitive should prices be to a cyclical decline in costs if price behavior is to facilitate the economic adjustments necessary to recovery? This problem is usually envisaged in terms of the price and output relations of individual products. The question is put: How much would the sales of a given product increase if the price were reduced by a given amount? The problem of price insensitivity on the downturn is, however, much broader than this. A price reduction is likely to affect the money incomes of the selling and buying groups, and consequently is likely to have repercussions on other prices and quantities. Furthermore, an isolated price reduction, other prices remaining insensitive, will have a different effect on the sales of the product concerned than if many prices are reduced.

Studies of the relation of price inflexibility to output changes on the downturn from 1929 to 1932 have led to the conclusion that, in general, outputs of those commodities fell least whose prices fell most, although there are many exceptions to this generalization. It is clear, however, that a distinction should be made between commodities for which demand is postponable and those for which it is not. With a marked decline in spending, the sales of the first type of product will probably decline regardless of price; the sales of the second are likely to be well maintained regardless of price.

Commodities for which demands are postponable are luxury goods, products where purchase requires a large initial expenditure, products whose life in use is subject to considerable extension. In general these commodities belong in the class of durable goods. If a distinction is made between durable and non-durable

goods, the relationship between price changes and quantity changes is likely to be much more illuminating than if all products are lumped together for the purpose of such an analysis.

The sales of durable goods fall markedly on the downturn, principally for two reasons. In the first place, the rate of use of these goods can frequently be continued for some time without replacement. The rate of use of automobiles as measured by gasoline consumption or car registration fell very little from 1929 to 1932, though new car sales fell violently. The rate of use of houses as measured by occupancy remained practically stable, while new construction sank nearly to zero. Secondly, and as a result principally of the extensibility of use, replacement may be delayed in expectation of price declines. It is this speculative aspect of the demand for durable goods which has led some observers to question the efficacy of price reductions as a stimulus to further sales during the downturn. Certainly it behooves both business and government to consider the effect of the way price is cut on the volume of sales. It is quite possible that, while a crumbling price will lead buyers to withhold purchases, sharp and sizeable price reductions, effectively timed, would have the opposite effect.

More important than the manner of price decline is an investigation of the probable consequences on volumes of output and employment of simultaneous price reductions for a number of products. A reduction of the prices of electrical appliances, electrical rates, and installation costs would probably have a very different effect on sales of electrical equipment even during a downturn than a reduction in equipment prices alone. A common reduction in building material prices, contracting charges, and building-labor wage rates would probably produce very different results in the housing field than a reduction in the price of one or a few materials.

If an objective of public policy is the facilitating on the downturn of those price adjustments necessary to early recovery, it will probably be found that certain prices and price relationships are much more important with respect to this objective than others. Interest rates belong in this category, and it may plausibly be argued that a reduction in the prices of capital goods may have the same effect of increasing the prospective yield on new capital investment as a reduction in the rate of interest. At the present time, however, it must be said that this problem has not

been investigated with sufficient thoroughness to permit conclusions. It stands as one of the important questions requiring further examination.

Finally, a public policy designed to promote greater price flexibility on the downturn will have repercussions on the flow of income and expenditure. These repercussions in turn affect the volume of output and employment. A consideration, therefore, of the probable influence of price changes on hoarding and spending is a part of the problem of price inflexibility.

In conclusion it may be said that, while readjustments in the price system form one of the conditions necessary to recovery, this is by no means the only condition. Studies of price inflexibility have thrown some light on types of price behavior which presumably handicap the attainment of this condition. Nevertheless, these studies must be pushed much further, and more attention must be paid to the relative responsiveness of the prices of particular commodities and services to changes in costs.

The question of what price policies and types of price behavior are conducive to a sustained recovery, and particularly what types are not, was undoubtedly one of the most important price policy issues broached in the discussions preliminary to the creation of the Temporary National Economic Committee. The view was widely held in Washington and elsewhere that the rapid rise in a number of industrial prices had an important effect in terminating recovery. It was the opinion of the President's Committee on Prices

> that a sharp rise in prices encouraged speculative inventory buying which, combined with the decline in housing construction, laid much of the ground for the present recession. We must do everything we can to prevent this from happening again.[4]

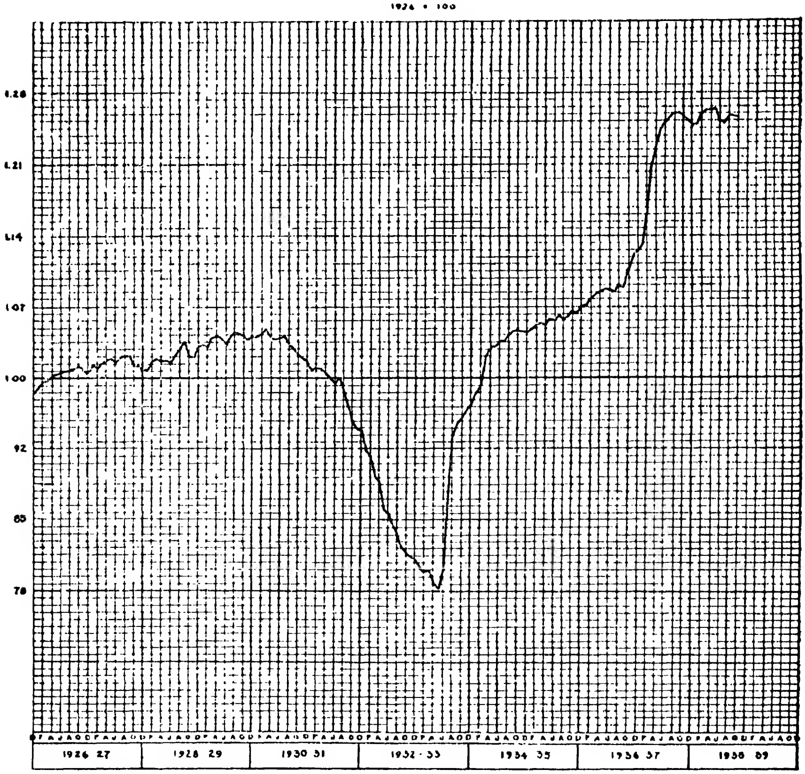
The question what price policies are conducive to sustained recovery is not limited exclusively to a period of cyclical upswing, nor does it relate exclusively to reëmployment induced by business spending. The effect on employment and output of any net increase in spending, public or private, will probably be affected by the way prices respond to this increase. Here again, as on the downswing, the question of the relation of price changes to the rate of employment is different if all prices are considered than if attention is limited to the field of commodity prices at wholesale.

If attention is so limited, it must be recognized that business

[4] Press Release, February 18, 1938.

firms are confronted with a price system in which many prices relevant to their costs and to the character of the demand for their product are largely outside their own control. In such circumstances a judgment on the effect of business price policies on recovery must take account of the area within which changes in price policies are both possible and likely to influence spending. For many consumers' goods — notably cotton textiles — the relative rigidity of retail prices means that considerable variation can take place in wholesale prices with no effect on volume of consumer sales. The rapid increase in hourly wages from November 1936 to June 1937 — though earnings are by no means identical with labor costs — is obviously relevant to a judgment on the increase in prices of manufactured products during the same period.

INDEX of AVERAGE HOURLY FACTORY EARNINGS
All Wage Earners - 25 Industries
1926 - 1938
1926 = 100



Source: National Industrial Conference Board.

Although the question of price policies proper to sustained recovery has occupied a prominent place in public discussion, it must be recognized that the issues have not been very satisfactorily formulated, nor have standards of proper price policies been forthcoming. Some price increases are presumably necessary to overcome resistances to increased volumes of output. Increases in wage rates and material prices must be largely passed on in increased prices of the product if business firms are to have an incentive to produce. Over and above increases in hourly wage rates and material prices, some increase in costs may be involved in more intensive utilization of fixed plant and equipment, though at rates of utilization common in recent years in most American industries this is probably small. Large and sustained price increases over and above those necessary to overcome such resistances are impossible without some considerable degree of market control. It is probable that a study of changes in the relationship of material prices and wage rates to prices of products may reveal at least the more obvious cases in which price increases are the result of market control positions.

Although the case is by no means conclusive, there is a strong presumption that prices which increase faster than is necessitated by the increase in wages and material costs handicap a sustained recovery. Such increases may well lead to a larger speculative inventory accumulation of materials and finished products than would accompany a slower price increase. On the other hand, the release of a potential demand for particular durable goods created by depreciation, during depression years, of plant, equipment, and housing may be indefinitely postponed by too rapid an increase in the prices of these goods. Furthermore, the exploitation of a temporarily favorable market situation by price increases may lead to the building-up of cash reserves which remain uninvested in the absence of expectations which only a sustained recovery would justify.

There is some evidence that business firms in 1936 and 1937 took an excessively short-run view of recovery and pursued price policies designed to produce maximum temporary profits. In many cases, undoubtedly, such policies were the result of a financial position weakened by years of persistent losses. In any case, it seems probable that price policies pursued in expectation of short-run recovery had something to do with making the recovery, in fact, short-run.

SUMMARY

The price system, or cost-price structure, is one indicator of the conditions on which producers and consumers engage in economic activity. In an economy in which no buyer or seller was able to influence prices, producers and consumers could scarcely be said to have a policy respecting price. Outside the markets for agricultural products and — on the buyers' side — the markets for consumers' goods, however, some ability to influence price is an almost universal characteristic of selling, if not buying, activity. Although the area within which prices may be influenced by individual buyers and sellers differs widely from market to market, the existence in all markets of this area of discretion creates the possibility of a policy with respect to price.

The attempts of sellers and buyers to seek their advantage by adjusting and controlling prices influences the behavior of prices in ways that are of consequence for the functioning of the economy. Not only is the distribution of resources between various uses, and of income streams as between the different groups of income recipients, influenced, but also the rate at which resources are utilized. In consequence, business price policies become a matter of public concern. It does not, of course, follow that all price policies should become the object of governmental action; still less does it follow that government should take action designed to make the formulation of price policy impossible.

Outside of the field of public utilities, price behavior has not been considered, until recently, of direct public concern. Implicit in the legislation and interpretation of the antitrust acts has been the conception that the price adjustments of individual firms independently determined under conditions of free and fair competition require no public scrutiny. The acceptance of various types of pricing techniques as prima facie evidence of violation of the antitrust acts, while involving a broadened interpretation, is perfectly compatible with this conception. On the other hand, if the behavior of prices is to be examined with respect to its consequences for the functioning of the economy rather than as evidence of the existence or nonexistence of a state of free competition in the market, other standards of judgment are involved.

Very little progress has been made as yet in the formulation of such standards. At the present juncture what seems to be needed

is a clearer formulation of the issues and a direction of attention to those problems which appear amenable to investigation. It is to these questions that the foregoing discussion has been directed.

INDUSTRIAL MARKETS AND PUBLIC POLICY: SOME MAJOR PROBLEMS[1]

Donald H. Wallace

INTRODUCTION

IT HAS BEEN repeated with pardonable monotony that we have never really tried to enforce the antitrust laws. A more pointed observation is that we have never really tried to find out what sorts of laws should govern industrial organization and business practices. If growing discussion of problems connected with industrial markets, appearance of opposing views about the results of existing industrial structure and business policies, and advocacy of very different programs of public policy are a sign of progress rather than a symptom of descent into chaos, we may be optimistic about the work of economists in this field in the last ten years. Yet if the conclusions found in most of this work intimate that present public policy is ill-adapted to yield the most desirable results, the analyses presented do not provide the knowledge sufficient to design any comprehensive change in public policy. In any event it is high time to summarize some of the principal views on the nature of the problems, on the results under present conditions, and on programs for public policy, and to attempt a definition of the major issues. That is the purpose of this article. In the main I do not attempt to answer questions but merely to set them.

The Sherman Act of 1890 seems to have represented the fear, on the part of a few people only, that the combination movement embodied a serious threat to freedom of enterprise and the danger of exploitation of consumers and labor; there was apparently no widespread public demand for such a statute.[2] For ten years the act was employed infrequently. During the ensuing decade of "trust-busting" only a small proportion of the many large combinations formed around 1900 were attacked. It would not be much exaggeration, perhaps, to say that for twenty years or so

[1] The study leading to this article has been greatly facilitated by grants from the A. W. Shaw Fund administered by the Committee on Research in the Social Sciences of Harvard University.

[2] J. D. Clark, *The Federal Trust Policy* (Baltimore, 1931).

after its passage no one — including judges, lawyers, economists, and business men — knew what the act meant with respect to close forms of combination, as distinct from agreements on price, output, or sales, which were from the beginning held to violate it. Beginning with the Standard Oil decision, the Supreme Court emphasized predatory competitive tactics as tests of illegality in a series of decisions in the few years after 1910. The statute began to have meaning as an instrumentality for preserving free enterprise through the prevention of monopolizing by bludgeoning or hampering tactics to deprive others of freedom to compete.

Partly, perhaps, because the Sherman Act had no clear meaning during its first quarter-century of life, dissatisfaction with it was manifested by many groups. During the decade preceding the passage of the 1914 legislation, the content of numerous Congressional debates, of the many bills introduced, and of public discussions attests considerable diversity of views on the nature of the problems and the remedies. In the light of recent proposals for reform in this field it is interesting to find that, among other things, the topics and remedies discussed included not only redefinition of restraint of trade, prohibition of holding companies, interlocking directorates, interlocking stockholdings, and unfair competitive methods, and inauguration of administrative procedure, but also limitation of the absolute size of corporations or of proportionate control of a market, the problem of control of scarce natural resources, federal incorporation or licensing, and the concentration of industrial and financial control in a broad sense. Out of a confusion of ideas and pressures evidenced by many changes in the bills destined to become the Clayton and Federal Trade Commission acts, there emerged a common denominator embodying the general principle that the Supreme Court had adopted in the preceding few years — preservation of freedom of enterprise or freedom to compete by the outlawing of predatory tactics, or of competitive methods bearing no relation to efficiency. The Clayton Act supplemented this by prohibiting, under certain circumstances, two control devices — the holding company and interlocking directorates — evidently regarded as artificial methods or easier methods of gaining monopoly control than consolidation of assets.

During the period 1890–1914 most economists saw no serious problems in the trust movement and paid no great amount of at-

tention to it. Factual studies of concentration of control or of the results of trusts were very few. With the exception of a small minority, economists seem at first to have viewed trusts as a natural product of evolution under free enterprise leading to greater efficiency. When private investigations and government inquiries produced evidence of methods of gaining monopoly power not based on superior efficiency, they held that the main problem was to eliminate such tactics. In the absence of predatory competitive methods, potential competition and the competition of a few smaller firms would hold the prices of trusts controlling even as much as 60 per cent of the market down close to their costs and force them to pass on to consumers most of the very considerable economy ascribed to combination. However, with the exception of a very few industries, which came to be considered "natural monopolies" and fit subjects for government regulation or public operation, it was thought that economies of combination were not sufficient to achieve the size necessary for monopoly power. No inconsistency between maximum efficiency and effective competition was seen.

When the public utility regulation, which spread rapidly through the states in the years 1900–15, is also taken into account, it becomes apparent that, on the eve of the World War, the general liberal theory of freedom and equality, the particular manifestation of it in economic theory, and the legislation concerning government and industry had been roughly integrated into a unified system. Government regulation or, in the case of municipalities, public ownership was to protect consumers from discriminatory treatment and extortionate prices in the case of the few "natural monopolies." The antitrust laws were to preserve freedom of enterprise and equality of opportunity in the broad field of industry and commerce, and free competition would prevent monopolistic exploitation of consumers or labor. For the sophisticated few there was the additional assurance that free competition would yield the most efficient use of the country's economic resources and a just distribution of income and wealth. All this represented very little break with the traditional reliance on free private enterprise to produce desirable results, for only in the case of the utilities, and to a small extent there at first, did government assume any responsibility to produce desirable results, as distinct from preventing undesirable ones.

Since 1915 the interpretation of the antitrust acts has held, in

the main, to the line of applying the general principles crystallized at that time. During the twenties there were some new currents in policy and in ideas, and after 1930 significant changes occurred in both. The change in public policy between the war and the New Deal took the form of exempting a few more industries from the antitrust acts and setting up special regulation for them. During the twenties, business men engaged in more coöperative or associative activity than in the pre-war period and increasingly called for revision of the antitrust laws to permit types of associative market control necessary to "balance supply and demand," "stabilize" business, and prevent "ruinous competition." This "self-government of business" or "industry planning" became a reality in NRA.

Economic analysis relevant to problems of industrial markets broke little new ground in the twenties. The work of J. M. Clark is a notable exception. But in the last ten years the appearance of the theory of monopolistic competition and new developments in the economics of business cycles and of the national income and employment have combined with changes in economic conditions and social philosophy to present the old problems in new form and to widen the scope of significant inquiry. We are now aware of the confusion of "free enterprise" and "competition" in the old theories. Both the theory of monopolistic competition and the NRA experience indicate also that the problems are very different in different markets. Recent developments have pointed to the variety of issues concerning public policy toward industrial structure and business practices.

Increasing attention to these problems has produced widely differing proposals for public action which may be classified into three groups: (1) restoration or revivification of free and effective competition; (2) collective negotiation or bargaining by organized interests in individual industries; (3) government-"managed" markets with government responsibility for producing desirable results.

The vigorous application of the antitrust laws by the present administration of the Antitrust Division, described by Mr. Feller in another article in this volume, should result in more effective competition in some situations. The fact that the present antitrust laws cannot remove or sterilize all monopoly power has led some to advocate a drastic change in public policy directed to this end. Others, to whom this seems undesirable or impracticable, propose

the extension of government regulation to produce desirable market results. These positions will be discussed in some detail below. The exponents of collective bargaining, under government supervision, between representatives of functional groups — such as management, labor, suppliers of materials, and consumers — to determine investment, output, prices, wages, and working conditions, the rate of advance in technology, and so on, have not explained very clearly the economic reasons why they consider determination of market results by such functional authorities superior to determination in other ways. Hence I include no discussion of their proposal in the middle portion of this article, where other schemes are reviewed, but deal with this program in a few remarks here.

The most forceful advocacy of this scheme of functional authorities is presented in the recent book *Prices and Price Policies*, by Walton Hamilton and associates, which contains several able studies of price-making in individual industries. Hamilton's proposal is in the tradition of individual industry-planning which led to NRA. Self-government by business, which still has a strong following among business men, is replaced by self-government (under public supervision) or planning by representatives of the interested groups. No criteria of desirable market results are formulated by Hamilton. Hence he cannot, and does not, undertake to demonstrate that market results with such a scheme would more closely approach a desired norm than they do with present market structures or other alternatives. The Hamiltonian dictum seems to be to start with the facts, see what is wrong, and remedy it. Although study of the facts can and should be of great aid in defining desirable norms, I fail to see how they can be formulated without the benefit of some general criteria of the desirable ends of economic activity. Hamilton's belief that functional authorities would present the best remedy must rest on a faith that the pull and haul and compromise of the interested parties will bring about more desirable market results than any other process or on the conviction that such organization and processes will represent an advance in economic democracy. Earlier generations placed their faith in freedom of competition to produce an undirected scheme of desirable market results and to advance democracy. As contrasted with government regulation or management, Hamilton's proposal for functional authorities is in both respects similar to the earlier ideas: a certain set of institutional arrangements is to

produce an unplanned plan of desirable results and to improve democracy.

Excluding the abortive NRA, changes in the law with respect to industrial markets have been much less significant since 1933 than the changes in public policy in most other fields. During the nineteenth century and the first quarter of the present century, government could afford to do little, and to make mistakes in what it did, without any very immediate danger to the fundamental institutions of liberal democracy. The diminishing rate of population growth, the filling-up of unsettled portions of the country (with the consequent reduction in the need for expanding the transportation network and the disappearance of rich unexploited natural resources), and the declining receptiveness of foreign markets for our goods — these have combined to reduce the profitable opportunities for new investment, and thus to enhance the responsibilities of government with respect to the size of the national income and the number of available jobs. At the same time there seems to have developed both a more widespread desire among the masses of the people to participate more abundantly in the things that this country can produce and to enjoy greater economic security than their forebears, and a belief that these objectives can be attained by more organization and more government action. It seems obvious that government action concerning industrial markets will increase in the near future. It seems equally plain that under the circumstances government must do things which promote increased efficiency in the broadest sense of community welfare, and that critical mistakes in policy are likely to be fatal to the preservation of liberal democracy, to say nothing of its higher development.

For this crucial test we are ill-equipped with knowledge of market processes. But there may be time to remedy the deficiencies if we set energetically about it. The first task is to discern what we need to know.

RECENT STATISTICAL AND THEORETICAL WORK

The most important recent work of economists relevant to problems of industrial markets may be divided into two parts: (1) that which is mainly theoretical or statistical or factual and does not lead directly to conclusions on public policy; and (2) studies which contain pronouncements or strong implications about public policy based upon inductive research or theoretical analysis or both.

Among the statistical and factual researches of the first category are studies of changes in broad price relationships, such as Mills's *Prices in Recession and Recovery* and the various well-known studies of productive capacity and purchasing power. These studies illuminate factual relationships, knowledge of which helps to set concrete problems that are significant for study directed toward the development of public policy; but in themselves they provide little basis for conclusions on general public policy or on policy in particular industries or segments of the economy. This is because they attempt little analysis of the relations between the factual relationships which they describe and norms of desirable relationships. In considerable measure the same comments are applicable to the government reports on experience with NRA. Finally, recent work seems to show that statistical derivation of demand curves, which, if successful, would be useful in measuring some aspects of monopoly power and shifts in demand, does not as yet yield satisfactory results in the case of industrial products.

Of recent theoretical work relevant to the study of public policy toward industrial markets the theory of monopolistic competition is the most important development.[3] Its true significance for public policy may, however, be easily misapprehended. The theory of monopolistic competition does not, as some appear to suppose, furnish any conclusions from which a concrete program of public policy can be directly derived. It does, however, direct attention much more incisively than the older theory to several important questions that must be studied before a satisfactory comprehensive program of public policy can be formulated. The old theory of competition formulated a norm of market results that was considered ideal, and at the same time showed that this norm would automatically be approximated in all markets where "competition" existed. (Implicitly or explicitly, competition meant, among other things, rivalry which did not contravene the accepted notions of "fairness" which were developed in the common law doctrines of "fair" and "unfair" competition.) The old theory of monopoly demonstrated that results differed from the ideal norm of the theory of "competition." According to the new theory of monopolistic competition, most actual markets contain both elements of monopoly and elements of competition. Instead of making the

[3] I here summarize the main conclusions of a forthcoming article on the significance of the theory of monopolistic competition for public policy.

simple classification into competitive markets and monopolistic markets, it suggests that the whole set of markets or "industries" exhibits many mixtures of competition and monopoly differing qualitatively or quantitatively. The likelihood is indicated that market results diverge under monopolistic competition from those described by the ideal norm of the old theory. The *variety* of possible results under monopolistic competition, both as between different markets and at different times in a given market, is emphasized. Variety may be due either to differences in blends of monopoly and competition or to differences in behavior of firms wherever existence of monopoly elements confers on executives a choice of policies.

These conclusions furnish no basis for any program of public policy. In the first place, although the theory of monopolistic competition shows the likelihood of the divergence of market results from the ideal norm of the old theory, it also challenges the validity of this norm in important respects, especially with regard to the failure to consider differentiation of product and selling costs and the possibility that efficiency of size and the benefits of competitive behavior may be mutually exclusive. As yet, however, the new theory has done but little in the difficult task of developing new norms of desirable results. Secondly, although theory can often show the probability of divergence from desirable market results, it cannot indicate the extent of divergence in actual situations. Factual study is required to ascertain how good or how bad the results are. The possibility, noted above, of great variety in kinds of results points to the great need for factual study of many markets. Thirdly, the new theory is principally a theory of the influence of monopolistic and competitive elements. Few attempts have yet been made to weave into it the consequences for market results of other important elements, such as uncertainties about demand or cost, types of fluctuation in demand or in costs, progressiveness, distribution channels, and the like. Finally, a program of public policy should rest on a showing of probability that better results than those existing with present industrial structure, business policies, and government control can be obtained by some alternative arrangements.

The theory of monopolistic competition should, however, be of great aid in developing programs of public policy. It points to significant questions for study. In showing that the questions are more complex than was formerly thought, it can help to prevent

mistakes in public policy based on simple answers to simple questions. It indicates the need for extensive factual investigation to aid in formulating more sophisticated norms of desirable results, to discover the extent of divergence from these norms and the elements responsible therefor, and to assist in the study of alternatives.

The particular questions to which it directs attention concern the relations between market structure, conditions of entry, and monopoly power; the relations between conditions in the market and the range of policy choices open to executives; the relations between size and efficiency and monopolistic policies; the results in markets where monopoly power inheres in the number and size of firms and conditions of entry; the kinds or degrees of differentiation of product that consumers want; the results of competition in differentiation; the relations between selling activities and the amounts and accuracy of information given to consumers; the relations between sales expenditures, sizes of firms, and allocation of economic resources.

The theory of monopolistic competition, then, furnishes no program of public policy other than an admonition to study the facts of conditions, policies, and results in most markets, to obtain answers to the significant questions which it implies, and to test the hypotheses which it raises. While these hypotheses question the desirability of the sort of "free capitalistic enterprise" now existing, they cannot be erected into a case against it without being tested by factual investigation and without study of alternatives. Empirical study along the lines indicated by the new theory has had a beginning.[4] The theory has also shown its merit by contributing both to the newly awakened interest in problems of public policy in relation to industrial markets and to the encouraging variety of ideas concerning the nature of the problems and what we should do about them.

[4] E.g., Arthur R. Burns, *The Decline of Competition* (New York and London, 1936); John M. Cassels, *A Study of Fluid Milk Prices* (Cambridge, Mass., 1937); C. R. Daugherty, M. G. de Chazeau, and S. S. Stratton, *The Economics of the Iron and Steel Industry* (New York and London, 1937); Donald Wallace, *Market Control in the Aluminum Industry* (Cambridge, Mass., 1937); Lloyd G. Reynolds, *The Control of Competition in Canada* (to be published shortly by the Harvard University Press), "The Canadian Banking Industry," *Quarterly Journal of Economics*, LII, 659 (August 1938); and "Competition in the Rubber-Tire Industry," *American Economic Review*, XXVIII, 459 (September 1938).

RECENT ANALYSES AND POLICY PROPOSALS

The most striking diagnoses and proposals or implications for public policy appearing in recent work in this field are those of Arthur R. Burns, Henry Simons, Gardiner Means, Mordecai Ezekiel, Nourse and Drury, and Walton Hamilton and his associates. With the possible exception of the latter, whose book has been mentioned above, all of these students seem to start from the same position — that the main problems arise from the widespread presence of large corporations possessing some monopoly power; yet they differ pointedly in their emphasis on the relative importance of different problems, in the type of treatment presented, in their interpretations of the results of the use of monopoly power, and in their views on the best public policy.[5] This diversity does not seem to stem from different philosophies of what, in the abstract, constitutes desirable economic conditions and social and political ideals. All these authors seem to desire that a continuous improvement of the general level of material well-being, accompanied perhaps by some diminution in inequality in distribution of income, should be achieved within the limits of social, political, and economic institutions which preserve and develop our heritage of freedom and democracy.

Henry Simons, in a brief pamphlet misnamed *A Positive Program for Laissez-faire*, outlines a series of comprehensive reforms relating to corporations, market organization, selling expenditures, money and banking, tariffs, taxation and the distribution of income. He argues that an immense growth of monopoly in many forms has become the gravest threat to the preservation of political

[5] Diversity of opinion extends also to reviewers. At a meeting of the American Marketing Association in Detroit in December 1938 the writings of Burns, Means, Nourse and Drury, and Hamilton and his associates were reviewed by four persons. Each reviewer condemned rather severely the analysis and results of the book assigned to him. Cf. also the differences in the following three reviews of Burns's *Decline of Competition*: Frank A. Fetter, "Planning for Totalitarian Monopoly," *Journal of Political Economy*, XLV, 95 (February 1937); W. H. S. Stevens, in *Columbia Law Review*, XXXVIII, 1126 (June 1938); Donald Wallace, "Monopolistic Competition at Work: A Review," *Quarterly Journal of Economics*, LI, 374 (February 1937); and the differences in two reviews of E. G. Nourse and H. B. Drury, *Industrial Price Policies and Economic Progress* (Washington, 1938) — Rufus Tucker, in *American Economic Review*, XXVIII, 753 (December 1938), and Donald Wallace, in *Journal of the American Statistical Association*, XXXIII, 766 (December 1938). I am indebted to the editors of the *Quarterly Journal of Economics* and the *Journal of the American Statistical Association* for permission to include in this article some of the ideas contained in my reviews cited above.

democracy and liberal institutions, and declares that these cherished elements in our liberal heritage can be preserved only by extensive dissolution of corporations, with the exception of a few public utilities, to the degree necessary to establish effective competition. For the rest, government must create and maintain surrounding conditions under which free competitive enterprise can function effectively.

Arthur R. Burns, in the best and most comprehensive treatise on the economics of industrial markets which has appeared in this country, also holds that an enormous growth in monopoly has occurred in the past sixty or seventy years, as is implied in the title of his book — *The Decline of Competition.* Despairing of attempts to reverse the trend, as Simons ardently wishes, impressed by the advantages of size and depressed by the consequences of widespread monopoly, he advocates extensive government regulation of investment, output, and prices in industrial markets where monopoly is important.

In *Industrial Price Policies and Economic Progress* Nourse and Drury continue the Brookings inquiry into the question of how to sécure full use of our economic resources and a rising standard of living for the mass of the people. They declare emphatically that executives of large corporations endowed with some monopoly power may use this power to promote the general welfare through rapid introduction of improvements, continuous price reduction, and capacity operations. Believing in the advantages of large size in relation to efficiency and progressiveness, and discerning what they consider a growing tendency on the part of big business executives to adopt constructive, low-price policies, they appear to oppose both atomization à la Simons and extensive government regulation as advocated by Burns and to hope that drastic changes in present public policy may be rendered unnecessary and undesirable by the spread of this new attitude among business men and by the increasing force of substitute competition accompanying the application of science to industry.

Mordecai Ezekiel, like the Brookings authors, is chiefly concerned with the problem of how to obtain full use of economic resources and increase substantially the incomes of the poorer part of the community. Believing that failure to secure maximum output and consumption is due largely to the use of monopoly power, destruction of which would materially impair efficiency, he advocates over-all planning for balanced expansion of output, higher

wages and profits, and lower prices in the major industries, the plans to be formulated and administered by coöperation between business men, labor, consumers, and government according to democratic procedures.

Gardiner C. Means attacks the problems of cyclical fluctuations and the long-run level of use of resources through analysis of price flexibility and variations in output and employment. He concludes that there has been a great increase in the degree and importance of price inflexibility, and that, in the absence of effective control, the presence of many inflexible prices alongside an area of flexible prices accentuates depression and constitutes a bar to the full use of resources. He proposes the adoption of government controls of different types, appropriate for different market situations, to keep the inflexible prices in line with the flexible prices, and monetary and fiscal policies designed to prevent the flexible prices from swinging out of line with the inflexible prices. The policies of the controlling agencies would be integrated in accordance with production–consumption patterns.

Henry Simons

Henry Simons' challenging views on the problems of monopoly direct attention principally to the effects of the growth of monopoly upon the institutions of liberalism and democracy. He declares briefly that business and labor monopolies impair [illegible] ref[illegible]omic efficiency through bad allocation and poor utiliz[illegible] expendi[illegible]omic resources, and through an inflexibility of prices [illegible]istribution which accentuates the severity of industrial fluctuations. [illegible]opoly i[illegible]in concern, however, is with the grave threat to freedom a[illegible] of [illegible]mocracy which he sees in the growth of monopoly. Economists and statesmen of the nineteenth century failed to recognize the significance of power politics in economic life. They assumed the legal and political institutions of liberal democracy as a framework for economic activity and raised no questions about the effects on these institutions of what happened in the economic arena. Well-meaning modern reformers, including many misguided economists, realize the existence of private power over market forces and hasten to urge the control of private power by public power, naïvely innocent of the inevitable result: replacement of freedom and democracy by authoritarian collectivism.

> Political liberty can survive only within an effectively competitive economic system. Thus, *the great enemy of democracy is monopoly, in all*

its forms: gigantic corporations, trade associations and other agencies for price control, trade unions — or, in general, organization and concentration of power within functional groups.[6]

Because the state has failed to preserve effective competition in industry, it is now faced with a serious dilemma. If it allows unrestrained use of monopoly power it may become dominated by powerful groups, and in any case, unless the growth of organized groups is checked, their economic warfare will result in conditions such that dictatorship is required to make the economic system produce and distribute enough for the people. On the other hand, if the state tolerates monopolistic organizations and attempts "to regulate their regulations," this will lead to an end of democracy.

Political determination of relative prices, of relative returns from investment in different industries, and of relative wages in different occupations, implies settlement by peaceful negotiation of conflicts too bitter and too irreconcilable for deliberate adjudication and compromise.[7]

Simons avers that the legislative history of the American tariff indicates the deplorable outcome of political manipulation of prices, wages, and profits. In his paper before the American Economic Association in 1935, he lays less stress on the danger from unregulated private monopoly, asserting that "the ways of competition are devious and its vengeance — government intervention apart — will generally be adequate and admirable," [8] but emphasizes the fact that powerful private monopoly is usually able to get help from democratic governments in protecting its position and its prices. But this route also leads him to the conclusion that private monopoly must be destroyed. Great inequality in power is quite as dangerous to democracy as great inequality in wealth and income. The alternatives are clear-cut: democracy, free enterprise, and effective competition, or authoritarian collectivism. Government control of market results is an ineffectual compromise containing, within the germs of its destruction, the seeds which produce dictators.

Simons contends that free, democratic institutions can be maintained only by drastic government action which first repairs the

[6] *A Positive Program for Laissez-Faire* (Chicago, 1934), p. 4. Italics in original. I have substituted the term "functional groups," which Simons uses in the next sentence, for "functional classes," in order to convey his meaning better.

[7] *Op. cit.*, p. 5.

[8] *American Economic Review*, Supplement, XXVI, 74 (March 1936).

errors of past statesmanship and then insures the continuance of effective competition and free enterprise in the future. The cardinal point in his comprehensive program is the creation and maintenance of conditions that produce effective competition in every industry where this is possible. To this end, the Federal Trade Commission should fix in each industry a maximum legal size of firm such that, as far as numbers are concerned, a condition of pure competition will exist. Simons evidently believes that in most industries this condition can be established without the dissolution of existing production units, merely by eliminating all devices for concentrating control of two or more plants in the same hands. Since control devices are a product of state corporation laws, he prescribes compulsory incorporation under a strict federal statute that would outlaw all control devices and prevent investment companies from exercising any control over operating companies. He also advocates an absolute limit on the total property which a corporation may own, perhaps to diminish the power of corporations as against the state. Where effective competition and efficiency are clearly incompatible, as in the railroads and some other public utilities, public ownership and operation should become the general rule, but this category of industries must be narrowly restricted. The objectionable compromise of government regulation should be used only in exceptional cases; and then, apparently, merely as a transition to public ownership and operation. These reforms are to be accomplished gradually.

Simons would like to sterilize the monopoly power of labor unions, but seems to consider this not politically feasible. He ventures the hope that labor monopolies would become much less important, given effective competition among employers, an efficient system of public employment exchanges, and a reduction in the severity of fluctuations in production and employment resulting from the monetary measures included in his program. Although he does not directly treat problems of differentiation, he advocates measures to reduce the wastes of competitive advertising and of an archaic system of marketing. These include heavy taxation of advertising, consumer access to wholesale markets, development of standards, labeling, and classification, and better consumer education.

While abolition of private monopoly is regarded as the *sine qua non* of true liberal reform, Simons proposes other drastic changes which he considers necessary to insure the satisfactory operation

of free competitive enterprise. Tariffs must be gradually eliminated to facilitate the extinction of monopoly and to protect democracy by abolishing legislative distribution of subsidies and favors in this field. Confident that extreme fluctuations of production and employment can be prevented by banking and currency reform, he proposes the so-called "Chicago 100 per cent reserve plan" and a national monetary authority to regulate the amount of currency according to a standard prescribed by Congress. Inequality is to be markedly reduced through a reform of the tax system making progressive income and inheritance taxes the principal revenue yielders and through enlarging the range of socialized consumption of medical services, recreation, education, arts, and social-welfare activities.

Although Simons obviously believes that monopoly power is inevitably used in ways that produce market results diverging greatly from those of a desirable norm — which he evidently considers to be the norm of competitive theory — he offers no proof of this. Similarly he does not demonstrate how or why inflexible prices intensify the severity of the cycle. Nor does he present much evidence for the view that in most markets creation of effective competition through increasing the number of firms would not entail any considerable sacrifice of efficiency.

These points are, however, only indirectly related to the main thesis that preservation of free institutions and democracy necessitates the destruction of private power. As he states it, Simons' case seems to stand on the fundamental assumption that there has been a tremendous increase in monopoly power in many markets in the past several decades. This assumption is also of high importance for the positions taken by Burns and Ezekiel. Yet none of them furnish much evidence on this point. No measure of growth of monopoly power is suggested or applied except the growth in absolute size of firms and the decrease in numbers of firms, in the country as a whole, in many industries.[9] The plain fact is, as Mason has pointed out, that we do not know for certain whether monopoly power is much greater in many markets now than it was at some period in the nineteenth century.[10] In many instances, changes in transportation and advertising may have

[9] Inflexible prices are noted as symptomatic of monopoly, but no evidence of historical change in degree of flexibility is adduced.

[10] "Industrial Concentration and the Decline of Competition," in *Explorations in Economics* (New York and London, 1936), pp. 434ff.

widened markets of individual firms enough to offset the decline in their number. Increase in the number and variety of close substitutes may have occurred in many instances also. On the other hand, even though the numbers in a national or large regional market may now be no smaller than the numbers in a more restricted sectional market of some decades ago, the restraints of "chain" competition from neighboring regional markets may have become less with expansion in the size of the market. And increasing differentiation of product has occurred side by side with the growth in substitutes. I think it likely that there has been a substantial net increase in monopoly power in industrial markets, but we certainly have no satisfactory evidence to prove this, to say nothing of demonstrating a tremendous increase.[11]

However, even if it were shown that there were few markets in which the large corporations possessed much monopoly power, or that there were few instances in which they regularly used their monopoly power to produce very bad results, Simons' case would not be entirely destroyed. For none can doubt that the great corporations and powerful labor unions and trade associations possess power to influence and interfere with legislative, administrative, and judicial processes, whether or not they can, without the aid of government, seriously impair the satisfactory functioning of their own markets. A plain threat to democracy exists in the danger that powerful economic groups may be able to prostitute democratic processes and to obtain legislation which injures the legal and political institutions of democracy. In fact, if private groups already possess anything like the amount of power which Simons ascribes to them, it is questionable whether the drastic changes that he advocates could be accomplished by democratic processes.[12] Indeed, his program will not only seem equally fantastic to reactionaries and to Communists but will probably be considered impracticable by most groups in the present American democracy. Yet it is certainly time for us to learn that the state should, if possible, destroy private power which has great potentialities for harm unless its existence is necessary to obtain very desirable results and its use can be effectively controlled.

[11] Of course, the important question is how much monopoly power there is now and how it affects market results. See below, pp. 107–113.

[12] Cf. the comment of A. R. Burns, *American Economic Review*, Supplement, XXVI, 94 (March 1936).

Simons raises questions about the structure and functioning of industrial markets which need extensive study. He calls attention to important interrelations between problems of markets and problems of labor, the business cycle, foreign trade, and taxation. Most important, he signalizes a serious danger to liberal and democratic institutions from the growth of private power. Finally, he lays out a comprehensive program, adoption of parts of which may be both advisable and practicable even if the whole seems undesirable or impracticable.

Arthur R. Burns

Arthur R. Burns's book, *The Decline of Competition*, contains more economics and less law than other books on American industrial organization. Burns asserts that the growth in the size of firms and the decline in their numbers in many industries during the past six or seven decades has meant a great increase in monopoly elements. The explanation of this development he finds in changes in the technique of production and marketing, the character of corporation laws and patent laws, and the interpretation of the antitrust laws. These changes have been accompanied by an increase in the importance of overhead cost and a tendency toward overcapacity. As a result, firms have increasingly sought to discover means of discouraging price competition. Burns presents an impressive volume of factual evidence of price leadership, market-sharing, price stabilization, discriminatory pricing, several types of non-price competition, and various activities of trade associations tending to affect prices and output. One or more of these practices appear to exist in many major industrial markets.

The consequences of these practices are analyzed in terms of long-run allocation of productive resources, utilization of capacity, prices, and profits. The effects of price stabilization on cyclical fluctuations in output, investment, incomes, and employment are also treated at some length. The analysis of consequences is almost altogether theoretical: the abundant facts in this book show the ways in which firms act rather than the results of their policies. The author's theoretical analysis of consequences leads him to the conclusion that the practices studied usually result in higher prices, higher profits or more unused capacity, and often in higher costs, owing to non-price competition, than would exist if competition in price were keener. He concludes that the results are so bad that the state must now choose between more vigorous

efforts to restore competitive behavior or an acceptance of the concentration of economic power, with government participation in its exercise.

The first alternative is dismissed as impracticable and undesirable. Mere prohibition of monopolistic policies such as price leadership, sharing the market, or price stabilization would be ineffectual. Competitive behavior could be restored only by removing the monopoly power inherent in the present organization of industries, the principal basis of which is large size. Reduction of sizes and increase in numbers of firms would, however, markedly impair efficiency in some industries; in any case, such a policy would defeat its own purpose, for when a firm attained the maximum size permitted by law it would have no further inducement to engage in price competition. In direct answer to Simons' proposal, Burns points out that "there is at present not even a tenuous basis for calculating the number of firms necessary to secure competitive behavior" in a market, even if the difficulties of defining a market can be resolved, and maintains that more vigorous representation of consumer interests by government is the best policy now. Moreover, "the acceptance of more direct control of industry avoids the necessity of reversing streams of tendency that have flowed deep and strong for over half a century." [13]

Hence Burns concludes that we must accept the present concentration of economic power. Believing that past experience, including the NRA, shows that use of monopoly power greatly impairs the national income and intensifies cyclical fluctuations, he holds that state participation in the control of the use of economic resources and of prices is both inevitable and desirable. Thus, clarification of social objectives assumes cardinal importance, and Burns devotes a chapter to a discussion of the effects of alternative policies in control of investment, output, and prices upon efficiency and upon the distribution, among different groups, of the benefits and burdens of economic change. No particular set of objectives is held up as clearly superior, nor are any definite criteria presented by which to distinguish those industries or markets — apparently a considerable number in Burns's view — which need positive control. Commission regulation is advocated as the best form of state control.

[13] Burns's criticism of Simons is in the *American Economic Review*, Supplement, XXVI, 90–94 (March 1936).

What is to be said of Burns's thesis? His failure to adduce adequate evidence of a marked decline in competition has been pointed out above. Secondly, he is wrong in maintaining categorically that the restoration of price competition by limiting the size of individual firms would defeat itself by the removal of all inducements to compete.[14] Provided that entry was unimpeded and that the number of firms was actually made large enough so that none could affect price, each would have to compete in order to survive. Moreover, each could enlarge its profits, at least temporarily, by cost reductions; again, the entry of new firms would tend to keep prices near costs. If the maximum legal sales of each firm were put in terms of a percentage of the total market volume, rather than an absolute amount, competition to maintain this share in the market would occur whenever total consumption was increasing.

Thirdly, in his theoretical analysis leading to the conclusion that the results of various practices are so unsatisfactory as to warrant state control of investment, output, and price, Burns does not definitely formulate a norm of desirable results. The nature of the discussion seems to leave no doubt, however, that in most places he has in mind as a norm the type of relations which would exist with pure price competition. (If not taken too seriously, I might remark that, since he often refers to these practices in the beginning as policies adopted to avoid price-cutting, he could have saved himself much painstaking and well-reasoned analysis by concluding at once that in such cases results must depart from the competitive norm.) Nevertheless, when it comes to the discussion of alternative possible objectives for state control, although no definite norms are specified, he sometimes seems to favor some compromise between the results with price competition and the results with maximum monopoly power implemented by state control.[15] But it is not shown that these desirable compromises are better than the present results, which also must often lie somewhere between these two extremes. In other words, it would appear that he sometimes suggests a norm for social control that may differ but little from the actual present results, which he has condemned by reference to another norm — that of pure competition. In any case, the discussion of social objectives does not conclude by approving the type of relations between investment,

[14] *The Decline of Competition*, p. 526.

[15] *Ibid.*, pp. 538, 550, 553.

output, prices, and incomes proper to pure competition,[16] although departure from the latter criterion appears, in most places, to constitute the reason why state control is held desirable. On the whole, it seems best to state norms of desirable results in terms of certain relations between investment, price, output, employment, and incomes *without reference to competition or monopoly*.[17] Again, in the treatment of non-price competition no definite norms are specified, but frequently comparison is made with the results under pure price competition.

In the fourth place, Burns has not, in my opinion, sufficiently heeded the warning issued by the theory of monopolistic competition that a given combination of competitive and monopolistic elements may yield any one of several different results. The one particular outcome characterized by high price, normal profits, and overcapacity poorly utilized is repeatedly stressed. Perhaps it is for this reason that only one type of social control is advocated, instead of different types to fit different situations.

The last two points are the most serious. The analysis of the consequences of monopolistic policies, being almost altogether theoretical, does not show whether market results diverge much or little from desirable norms. Because of the scarcity of factual data on results, as well as the failure to define norms explicitly, this book does not demonstrate that results are bad enough to bother about. Recognizing that monopoly elements are nearly ubiquitous and observing that monopoly power is often used, Burns jumps to the unverified conclusion that the quantitative importance of undesirable results is so great in many markets as to make government regulation desirable.

The results in many markets may, indeed, be exceedingly unsatisfactory, but only a factual study of results can show whether or not this is so. Unfortunately, few satisfactory studies of market results in particular markets or groups of markets have yet been made. Obviously no one scholar can make such studies in a large number of markets. It follows that it is at present impossible in any general survey such as that of Burns to ascertain

[16] I use the phrase "type of relations" to avoid denoting the actual quantitative relations under pure competition. If minimum cost is incompatible with the conditions necessary for pure competition, then the actual results of pure competition are a poor norm.

[17] This does not mean that competitive theory or, for that matter, monopoly theory is not useful in defining norms.

the facts necessary for sweeping conclusions on the best public policy applicable to a large number of markets.

Finally, Burns's conclusion must also depend on the assumption that regulation is politically and administratively capable of bringing an improvement over present results. The questions involved in this assumption are not discussed, nor is commission regulation compared with other instruments of social control, such as government competition or public monopolies.

Nourse and Drury

In *Industrial Price Policies and Economic Progress*, Messrs. Nourse and Drury consider the relation between the price policies of large corporations and the degree of use of economic resources and real income of the mass of people. They are concerned with the long-run level of output, employment, and income, and explicitly omit direct consideration of cyclical problems or other short-run problems. The background of their inquiry is the earlier studies of the Brookings economists on capacity, consumption, income, and economic progress, rather than the fears of stagnation at a low level of use of resources recently voiced by Hansen, Keynes, and others.

The authors start from the same position as Burns: that changes in industrial organization have endowed executives of large corporations with substantial power over prices and other market results. They point out that in many markets competition is no longer an automatic regulator and guarantor of maximum progress, but they dispute vigorously the conclusion of Burns and others that power over market forces is automatically or even usually exercised in ways which yield bad results. Such conclusions arise, they maintain, from a failure to recognize the *variety* of policy choices open to executives [18] and the potentialities of technical progress which enrich this variety. Large corporations enjoy appreciable monopoly power, but they also possess great advantages over small firms for the improvement of efficiency in production and marketing. Their managements have a range of policy choices between the most restrictionist policies at the one extreme and the most energetic and resourceful endeavors to reduce costs and prices, and hence to enlarge output,

[18] I.e., executives of large firms. The book deals only with the policies of corporations large enough to affect the prices in the markets for their products. As with Burns, differentiation comes in for little direct treatment.

employment, and consumption, at the other extreme. The rate of use of economic resources and the rate of increase in the real income of the mass of people depend in large measure on whether managements choose the easy course of protective, restrictionist policies or courageously embark on determined attempts to find ways of satisfying more wants within the limits of the money purchasing power of the masses of the people. It is incorrect, Nourse and Drury argue, to conclude that the policies actually selected are necessarily of the former sort. Whereas Burns sees in the economic history of the past half-century a trend to more and more restriction, they discern, at least since the war, a growing tendency for many large firms to adopt and carry through successfully policies of vigorous progressive advance and price reductions. They maintain that, if these courageous and imaginative policies become generalized among large corporations, we shall have full employment and capacity operations, and an increasing national income.

This book does not attempt to discuss "the question whether the legal or other institutions which permit or foster administrative control over prices are themselves beneficial or harmful features of the existing economic system." [19] No direct pronouncements on public policy are made. The authors hold, however, that the dissolution of large corporations to restore atomistic competition would rob us of the progressive advance of which large corporations alone are capable. And, in direct answer to Burns, they maintain that competition is far from dead, that, on the contrary, the competition between industrial giants is much more effective than the older competition between small firms in perfecting new techniques of production and organization which bring more and better goods within the reach of the masses. They appear to think that, for the present at least, the most promising route to better use of resources and a rising level of income is through encouraging business executives to adopt constructive low-price policies instead of through further extension of government control.

Although the book thus contains a forceful attack on current views emphasizing the ineffectiveness of competitive forces and the desirability of more government control, its main purpose seems to be to show business executives the social importance of their policy choices and to suggest to them that there are prob-

[19] Page 3.

ably opportunities for progressive advance and price reductions which they have not yet fully explored. A large part of the book is devoted to a discussion of the relations between rate of operations, costs, prices, and profits; to a consideration of the sorts of changes in processes, product, sales promotion, and pricing policies which promote capacity operation and larger consumption; and to an examination of types of sales promotion and accounting procedure and of various external influences that operate in the direction of high-price policies.

Although the purposes, scope, and tone of Burns's book and that of Nourse and Drury differ greatly, there are also significant similarities. Each book emphasizes a trend — in the one case, the growth of monopoly power and restrictionist policies; in the other, the growth of policies of progressive cost and price reduction — but in both cases the evidence presented is too meager to show the extent of the change involved. In neither book are norms of desirable results, applicable to specific situations, clearly formulated. Nor does either book present any extensive factual analysis of results in many markets.[20] In both, the facts set out are principally facts about policies. Hence, when it comes to public policy, neither the conclusion of Burns nor the implications of Nourse and Drury rest on a substantial foundation.

The authors of *Industrial Price Policies and Economic Progress* seem to believe that generalization of progressive, low-price policies can bring "the fullest possible utilization of all the plant that can be made to pay its way," [21] the introduction of improved equipment whenever efficiency can be increased thereby, and full employment of labor and a rising standard of living in the community as a whole. Perhaps because the book is addressed to business men (as well as others) some of these objectives are not precisely formulated in terms of quantitative relations. An obvious corollary of the belief just stated is that existing price, investment, and output policies in a considerable segment of big business are a major obstacle to the attainment of these objectives. Whether or not this is really so is a question of the highest importance, but I do not think this book throws much light on the answer. Here we find the proposition implied, not demonstrated.

The authors distinguish in a general way between desirable and undesirable policies according to whether they promote or

[20] Nourse and Drury present case studies of policies and results in a few markets.
[21] Page 89.

hinder the attainment of the objectives mentioned above, but tests for making this distinction are not clearly formulated. The conventional test of the rate of profit appears to be discarded. Provided costs and prices are being continuously reduced, large profits are held to be consistent with desirable low-price policies; [22] or else the possibility of considerable restriction, evidenced in high profits or idle capacity, accompanying continuous reduction of costs and prices, is overlooked. Discrimination in prices charged to rich and poor is advocated as a means of extending operations and consumption. It is not pointed out, however, that this will lead to larger output and consumption than would occur with prices equal (on the average) to full average costs, including normal profits, only if the poor are charged less than full cost and profits are merely normal. Business men who were making large profits through a policy of charging prices at least equal to full costs to consumers with low incomes, and higher prices to those better off, might innocently believe, after reading the section on discrimination, that they were doing exactly what the authors wished to encourage — and this belief might be correct. Again, the lack of precision in defining tests to distinguish desirable and undesirable policies is shown in the difficulty frequently encountered when one tries to decide exactly why the authors assessed as they did the policies examined in their brief case studies.

The authors do not attempt to decide definitely whether or not full employment, capacity operations, and a rising standard of living *would be achieved* if every large firm did all that it could do *by itself* to promote the attainment of these objectives by reducing costs progressively as much as possible, and lowering prices continuously to expand consumption as far as possible, without endangering the minimum profits necessary for survival and for the rapid progressive development. Nor do they aver that most executives *will* adopt such policies. The tone of the book suggests, however, that they are quite optimistic on both these points.

They seem to divide market situations into three sorts: (1) those in which competition of substitutes resulting from the new applied science compels progressive, low-price policies; (2) those in which the existence of monopoly elements permits a choice between restrictionist and low-price policies, but in which the latter

[22] Or perhaps the distinction would be made to turn partly on whether or not a part of the profits were used to develop and introduce improvements further reducing costs or increasing quality.

are just as profitable as the former, or more so; and (3) those in which the possibilities of further cost and price reductions are very limited. The authors appear to think that, where the third situation exists, executives can still be sufficiently educated in their social responsibilities to adopt moderate policies. The book gives no indication of the quantitative importance in large-scale industry of these three different situations.[23] Is it, perhaps, significant that most of the illustrations of progressive, low-price policies seem to be drawn from the newer industries?

In my opinion the Brookings authors probably underestimate the attractiveness of high-price, restrictionist policies and sales promotion devices as compared with price competition. Furthermore, their discussion of business policies proceeds *in vacuo*, as it were, with respect to the surrounding conditions, such as rate of population change, amount of savings, kinds and extent of government control influencing price policies, public spending, and so on. And, finally, since they confine their attention almost altogether to a consideration of what the individual firm can accomplish by *competing* with others in reducing costs and prices, their analysis throws little light on the question whether much more could not be accomplished by coöperation between firms or industries in reducing prices and expanding output, as Ezekiel maintains.

The most important contribution of this book to the study of industrial markets would seem to lie in its emphasis on the existence of policy choices[24] open to executives and on the importance of progressiveness, which have both been much too little appreciated by others working in this field.

Mordecai Ezekiel

As we have noted, for Ezekiel as well as the Brookings authors the main problem is how to get industrial markets to function in ways which will bring full use of our economic resources and a substantial increase in the real incomes of the mass of people. Although he lays more stress, perhaps, on the latter objective as an end in itself, he also seems to regard it as a necessary condition for the attainment of full use of resources. Nourse and

[23] A quantitative study of this matter would, of course, be exceedingly difficult.

[24] This emphasis emerges even more distinctly in "Monopolistic Practices and the Price Structure," by Edwin G. Nourse, *Proceedings of the Academy of Political Science*, XVIII, 11ff. (1939).

Drury evidently believe that, for the present at least, progress toward this twin goal can best be promoted by an appeal to business executives embodying a judicious mixture of education in economic principles for the unenlightened, exhortation for the recalcitrant, and approval for the constructive. Ezekiel, on the other hand, is convinced that it cannot be reached without overall planning and coöperation between government and business in major industries.[25] This belief evidently registers his agreement with Simons and Burns that a great increase in the monopoly power of firms in many markets has been accompanied by a growth in restrictionist policies.

He argues that, when many major markets contain but a few large corporations, competition becomes ineffective in achieving full use of resources — that is, that the policies of individual firms and separate industries are not automatically dovetailed by competitive forces into a pattern which produces that condition. The great corporations reduce costs, but fail to lower prices or raise wages enough to expand the markets for their products in sufficient degree to produce continuous full use of resources. Depression seems to be regarded as merely an accentuation of a "normal" condition of under-utilization. Among policies interfering with self-regulatory market action, a special share of the blame is accorded to price inflexibility, particularly in depression. The consequences of restrictionist policies have become worse since the war, owing to the reduction in the rate of population growth and a decline in the general price level. Other factors mentioned as tending to hinder full use of resources are immobility of labor, restriction of investment opportunities in some fields by banker protection to established firms, and diminishing receptiveness of foreign markets.

Given these conditions, says Ezekiel, continuous performance of the economic system at a deplorably low level is probable simply because no individual firm or industry can see any advantage in expanding its output substantially. He shares Simons' fear that exercise of great economic power by large corporations and labor unions may lead to an authoritarian regime if we do not prevent this by comprehensive measures. But Ezekiel, like Burns and the Brookings authors, emphasizes the impossibility of creating effective competition without greatly impairing efficiency, and

[25] *$2500 a Year* (New York, 1936) and *Jobs for All Through Industrial Expansion* (New York, 1939).

contends, more forcefully than Burns, that the conflicts of powerful economic groups can be resolved by the spirit and processes of democracy if we really try to do it. Industrial expansion takes its place alongside the myriad other schemes to save capitalism and democracy.

The restrictionist stalemate which now prevents full use of resources would be resolved, says Ezekiel, if a group of major industries agreed to expand together. Each would be assured thereby of a sufficient increase in demand to make the expansion of its own output profitable; the total national income would rapidly be raised; and in many industries the reduction in unit costs would permit lower prices and higher wages as well as larger profits. The national income could be increased by ten billion dollars a year for three or four years, bringing it to a level such that most of our families could receive at least twenty-five hundred dollars a year. Coöperative planning by business, labor, and government can achieve these objectives without destroying private enterprise and will at the same time maintain and strengthen democracy. It should be applied in all major industries where monopoly elements hamper expansion and in those where competition degenerates into excessive wage-cutting. Regulation of public utilities should be tied into Industrial Expansion.

The method is the preparation of a series of annual plans for the balanced expansion of production and consumption in the major manufacturing industries and large public utilities. Retailing, wholesaling, service industries, small-scale manufacture, and the like, where competitive forces can be relied on to yield satisfactory results, would not be included in the scheme. The annual estimates for each industry would be based on probable consumption — consumers being free to spend their incomes as they desired — assuming certain increases in the money incomes of the different groups. In addition to output and employment specifications, each annual plan would indicate the prices — maximum and minimum prices with a 10 per cent range for price competition — and wages appropriate to insure consumption of the total product of all industries and to obtain an increase in the real income of all groups, so divided as to enlarge in greater proportion the incomes of the poorer groups. The plans would call for expansion and replacement of equipment by regular annual increments, thus eliminating marked fluctuations in the operations of equipment industries. Mistaken estimates would be

corrected by revision of programs during the year, by changes in subsequent annual plans, and by government purchase, at a discount, of unsold surpluses.[26] Activities pursuant to carrying out the plans would be exempted from the antitrust laws. In so far as corporations withheld coöperation in the formulation of plans and compliance therewith, government would have to impose plans and resort to sanctions, of which several possible types are mentioned — processing taxes and benefit payments, direct regulation, penalty taxes, withdrawal or suspension of privileges such as tariffs or patents.

The formulation, integration, and administration of industry plans would be worked out at each stage by democratic processes of proposal, discussion, and compromise, participated in by representatives of business, labor, consumers, and government, sitting on individual industry authorities, inter-industry authorities, and a national authority with final responsibility. Regional boards or divisions of the national authority would be set up wherever effective decentralization would be facilitated thereby. Ordinarily a plan would be put into effect in a given industry only if it had the approval of a majority of the industry. Review by the national authority in the interests of proper integration of all industry programs would provide a guard, thinks Ezekiel, against attempts of individual industries to gain at the expense of everyone else.

The Industrial Expansion scheme really amounts to the replacement of the uncoördinated planning by individual large firms (or, in some instances perhaps, whole industries) which now exists by coöperative inter-industry planning, with participation by representatives of business, labor, consumers, and government — with large final power in the hands of government. To integrate the individual programs so as to secure greater use of resources all around and consumption of all that was produced, and to achieve the objective of raising wage incomes more than profit incomes, there would surely need to be a large use of government authority in the determination of prices, wages, profits, and output, and hence indirectly in the allocation of productive resources. Unless, or until, business executives and labor leaders came to regard as their main function planning for the good of the community

[26] Government would incur no losses on this account, according to the author, because operation of the scheme would automatically increase government revenues and reduce relief expenditures.

as exemplified in the objectives of the scheme, the scope for activity of private executives would probably have to be restricted to reporting essential data, suggesting and discussing plans, and making the decisions about investment, production, selling, and employment necessary to carry out the final individual programs called for by the national plan.

Discussion of the Industrial Expansion scheme may be divided into its economic and its political aspects, although these are often too closely related to separate clearly. Most economists would probably agree that the general economic principles required to operate such a scheme are well enough known. Great difficulties would be encountered in particularizing these principles and in implementing them with facts, as Ezekiel himself repeatedly emphasizes.[27] But given the facts necessary for such planning and able men trained for it, the task would appear to be far from insuperable. It might be well, says Ezekiel, to spend a few years before launching the scheme in gathering the facts — of which we now possess but fragments — and in studying the problems. The success of the AAA is explained as largely due to a decade or more of work in the Bureau of Agricultural Economics in studying the main problems, assembling relevant facts, and promoting mutual understanding and respect between farm people and government people.

Some will object that Ezekiel gives too little attention to the problems of the allocation of economic resources and their utilization, once allocated. Putting it somewhat loosely, he evidently means by full use of resources a condition such that every em-

[27] Ezekiel does not develop the economic principles of the scheme very far in either book, doubtless because he has written for the general reader. He discusses quite superficially the principles according to which prices, wages, and profits might be fixed, but does not consider the possibility that wages might be raised too rapidly to obtain full employment unless government authority was used to prevent this. The scheme would encourage organization of labor so that labor could participate effectively in the industry authorities. Hence wage increases would be more probable than price reductions, for ultimate consumers would probably not be well organized. He recognizes that introduction of innovations would need to be coördinated with prices, wages, profits, and output quotas, but concludes that this phase of the problem, which would involve unknown difficulties, should not be tackled until Industrial Expansion had been operating for some time. Little attention is paid to cyclical complications, perhaps because the author thinks that his scheme would go far to eliminate the business cycle. He does not, however, discuss such problems as how to balance savings and investment or how to treat the tendency of innovations to cluster. It is pointed out that appropriate policies with regard to money and credit, taxation, foreign trade, and so on, would be required to facilitate successful operation of the scheme, but they are not discussed in detail.

ployable person is employed somewhere, there are no idle funds of money savings, and equipment is everywhere quite well utilized. With full employment of men and savings there might, of course, be a poor allocation of productive factors and much unused equipment, particularly if monopoly power were permitted to influence the specifications of the plans. It is most probable, however, that full use of resources, merely in the sense of absence of idle men and idle savings, would result in a much greater national income of satisfactions than this country has ever yet enjoyed, even though the allocation of resources diverged appreciably from the ideal and though some equipment was not fully utilized. The central coördinating board should, of course, be able to prevent instances of very bad allocation or marked under-utilization. There is wisdom in Ezekiel's implication that it is time enough to bother about niceties of allocation and utilization when we are much nearer the goal of full use than now.

A more important question concerns the extent to which a low level of output in the whole system is really due to the use of monopoly power. Ezekiel seems to take it for granted that there has been a tremendous growth in monopoly power in many major industrial markets and that the poor use of resources is mainly due to the decline in competition. But he presents very little factual analysis to support such a belief and his theoretical treatment raises more questions than it answers. Effective competition still exists, he says, in many other markets, such as textiles, clothing, shoes, the service trades, and the like. However, it is not explained why competition in such a large segment of the economy fails to result in use of resources not employed in monopolistic industries.

If it is true that a major obstacle to full use of resources is monopoly in many industries, some scheme which, like Industrial Expansion, provides for an agreement between business men and labor of several industries to expand output and investment is superior on economic grounds to measures applied to a few individual industries only. If it is not true, however, that monopoly is a principal cause of a low level of performance in the economic system, a remedy which operates directly on the important causal elements might be better than Industrial Expansion, particularly in view of the serious political problems incident to the latter. I think we simply do not yet know the extent to which monopoly is responsible for the failure to make use of a large part of our

productive resources. It is theoretically conceivable that with the purest competition imaginable existing in all industries there could be persistent "underemployment equilibrium." This condition might obtain if opportunities for profitable expansion, as seen by business men and investors, did not keep pace with the increase in the employable population and the growth in savings, perhaps because innovation proceeded too slowly, or if business men came to distrust more and more the activities of government. Declines in wages and interest rates might fail to restore full use of resources because most business men anticipated a consequent diminution in the amounts spent on their products, or because people desired to hoard substantial parts of their incomes. The seat of the trouble may lie not in the failure of competitive forces, but in poor functioning of other elements in free enterprise or, perhaps, in mistaken government policies. For example, it is arguable that free enterprise is not so well adapted to produce more and more of old goods for a nearly stationary population — in other words, to energize Say's law — as it was to produce new things and more old goods with an expanding population. Moreover, some monopoly may be necessary in order to have rapid progressiveness and to open up sufficient gaps between prices and costs at appropriate times. The whole question of the relation of monopoly to the extent of use of economic resources needs intensive study.

Even if Ezekiel's diagnosis of the trouble is wrong, however, his remedy may not be inappropriate if direct operation on the true causal elements is unsuccessful, or if the more important causes cannot be distinguished. If, as seems probable, Ezekiel is right in his belief that monetary policies and pump-priming are incapable of attaining and holding full employment, then his scheme is to be compared with other broad schemes, such as continuous public spending,[28] which are proposed as methods of achieving this goal. Industrial Expansion is not to be judged solely as a remedy for monopolistic hindrances to full use of resources.

Regarded from the economic side alone, Industrial Expansion seems capable of greatly increasing the national income and improving its distribution. But the fulfillment of its promise would require both more highly organized management and labor groups

[28] As advocated in *An Economic Program for American Democracy* (New York, 1938), by seven Harvard and Tufts economists.

and power on the part of government authorities to control effectively output, prices, wages, and profits. The potential monopoly power, and power to influence government, possessed by private groups would necessarily be enlarged. Hence the power of government to control these groups would need to be increased. Could such a scheme be made to work effectively without destruction of democratic relations and processes or free consumers' choice or both? Ezekiel maintains that his scheme could be operated by democratic processes, that it would extend the principles of democracy farther into the economic realm than heretofore, through the participation of representatives of all groups in designing and administering the plans, and that political democracy would become more firmly entrenched as it demonstrated its ability to solve serious economic problems. In *Jobs for All* he contends forcefully that Industrial Expansion is far removed from Fascism and Socialism in administrative organization, procedure, objectives, and relation to the institution of property.

The main question which remains in one's mind, however, is whether government would not need to become more and more dictatorial in order to make the plan operate satisfactorily. Could the spirit of democracy and the processes of democratic government stand firm in the face of the tremendous burden inherent in the necessity of preventing a stalemating pull and haul between powerful private groups? Could they survive the invitation to minorities to attempt the seizure of a government endowed with such great power over economic relations? Simons and many others would doubtless say no. Some of us are optimistic, and many of us want to be optimistic, about the possibilities of democratic social control of the use of economic resources and of the distribution of wealth and income. The seriousness of the political problems involved must not be underrated if we consider the preservation of democratic methods and liberal institutions a good to be sacrificed temporarily only under most urgent necessity, nor can they be overestimated if we wish to avoid drifting into authoritarian government through failure to cope with grave economic problems. It is imperative that the political aspects of programs developed by economists be widely discussed and evaluated by those who know most about democratic principles and processes, bureaucracy, and the potentialities of the American people. Although the immediate practical importance of Ezekiel's proposal is doubtless no greater than that of Simons' program, it merits

serious study by all who are interested in the future development of our political and economic institutions.

Gardiner C. Means

Following his work on the large corporation and the holding company, Gardiner C. Means turned his attention to the functioning of modern markets in relation to the business cycle and the long-run trend in the level of use of resources, problems which he seems to regard as nearly identical. From an analysis of the behavior during the years 1926–35 of the monthly wholesale prices reported by the Bureau of Labor Statistics he concludes that the economy is divided into two very different sorts of market. In the one, there is competition of the traditional textbook kind, with flexible, automatic price adjustments to changes in demand or supply conditions; in the other, there is "administrative" competition between a few firms, with "administered" prices — that is, prices that are held constant over a period of time, adjustments being made through variations in production and employment.[29] Means finds a marked positive correlation between frequency and amplitude of price change. A comparison of variations in prices and production in ten major groups of products between 1929 and 1933 exhibits a high inverse correlation between the percentage drop in price and the percentage decline in production. In the years 1929–32 the flexible prices fell away from the inflexible prices in a widening gap, while in the period 1933–35 the former reapproached the latter. Means concludes that the presence of many inflexible prices in a large segment of the economy greatly intensifies the severity of depression and constitutes a serious obstacle to the attainment and maintenance of full use of economic resources, because the effectiveness of the market as an over-all coördinator is destroyed. He seems to argue that in a flexible-price economy neither changes in the total supply of money (relative to the demand for money) nor disparities between the amount of funds saved and the amount invested could result in depression, because price adjustments would continuously maintain maximum output, employment, and consumption. Provided

[29] *Industrial Prices and Their Relative Inflexibility* (Sen. Doc. no. 13, 74th Cong., 1st Sess., 1935); "Price Inflexibility and the Requirements of a Stabilizing Monetary Policy," *Journal of the American Statistical Association*, XXX, 401 (June 1935); "Notes on Inflexible Prices," *American Economic Review*, Supplement, XXVI, 23 (March 1936); with Caroline F. Ware, *The Modern Economy in Action* (New York, 1936).

prices were all perfectly flexible, even the interest rate could fail as a regulator of investment and savings without ill effects. Inflexible prices intensify the severity and prolong the duration of depression in two ways. An initial drop in demand in the inflexible-price area is met by curtailment of output and discharge of labor. This reduces workers' purchasing power and causes a drop in demand for other products. In so far as these are in the "administered price" area the process is cumulative, with growing unemployment, diminishing production, and declining purchasing power. Secondly, the necessary adjustments in the flexible-price area are made more severe, and people there suffer a correspondingly greater decline in real income. The chief problem is no longer that of monopoly profits, says Means, but the effect of inflexible prices on the functioning of the whole economy.

Turning to remedies, Means discards the restoration of pure competition because efficiency would suffer greatly from the necessary pulverization of large firms. He advocates a series of new government controls.[30] Control of the total volume of money and credit must be centralized in order to vary the total so as to prevent the flexible prices from departing in either direction from their proper relation to the inflexible prices. Excess of savings over investment must be corrected by government spending on public works or unemployment benefits or relief payments. But although monetary and fiscal policies can prevent distortions arising from maladjustments in the supply and demand for money and in savings and investment, they cannot, says Means, insure the fully effective operation of the economy. Large firms can nullify their effects by ill-timed price increases or failure to raise wages at appropriate times. The level of activity in the whole community, the distribution of the total income, and the relations between flexible and inflexible prices are dependent in the last analysis on the policies of the large corporations. Hence some government control of their policies is indispensable. This may take different forms, appropriate to different market situations — government ownership and control, government administration with private ownership, commission regulation, benefit payments, determination of key policies through a body representing all interests, collective bargaining, producers' or consumers' coöperation. The danger of inter-industry maladjustments would necessitate a general outline of objectives for the guidance of all the agencies

[30] The remedies are discussed principally in *The Modern Economy in Action.*

engaged in control of the various phases of the problem. There is little discussion of criteria to distinguish types of control appropriate for different sorts of market situations, or of the problem of integrating controls in such a way as to attain the objectives. The extent to which government must command changes in price, production, and labor policies, instead of merely playing the role of arbiter between the interested groups, remains undetermined.

A brief discussion of Means's ideas may be centered on the question of the increasing importance of price inflexibility, the reasons for price rigidity, and Means's analysis of its effects. Since his treatment of proposed remedies, especially in the case of industrial control, is evidently meant to be no more than suggestive, further discussion of these will be omitted.

Means did not investigate the historical question of the extent or degree of change in flexibility of prices in the economy and the elements responsible therefor, perhaps because he considered it of secondary importance. He evidently believes that "administered" prices have become characteristic of a much larger part of the whole economy during the past one hundred years. Some ambiguities of expression make it impossible to decide whether Means ascribes this change principally to the growth in size and decline in number of firms in many industrial markets, as he implies in places, or to other changes.

Several studies of the frequency and amplitude of changes in wholesale prices during successive periods in the last fifty years and selected periods in the preceding half-century indicate that in all of the periods examined there were many prices showing a high degree of inflexibility according to various measures of flexibility.[31] It is probably impossible, however, to measure even roughly the relative importance of the inflexible price areas in the whole economy at various periods, owing to lack of data. Their importance in terms of proportion of the national income may be much greater now than fifty or one hundred years ago, owing to the changes in the relative importance of agriculture, industry, public utilities, and professional services. Moreover, since the studies mentioned

[31] F. C. Mills, *The Behavior of Prices* (New York, 1927), pp. 379ff.; D. D. Humphrey, "The Nature and Meaning of Rigid Prices, 1890–1933," *Journal of Political Economy*, XLV, 651 (1937); Rufus S. Tucker, "The Reasons for Price Rigidity," *American Economic Review*, XXVIII, 41 (March 1938), and "The Essential Historical Facts about 'Sensitive' and 'Administered' Prices," *Annalist*, February 4, 1938; Edward S .Mason, "Price Inflexibility," *Review of Economic Statistics*, XX, 53 (May 1938).

treat flexibility merely in the sense of statistical price behavior, without relating such behavior to measures of change in price-determining variables, they afford no evidence as to whether or not there has been a change in the relative responsiveness of prices to changes in such variables.[32]

Most of the work on price inflexibility has been devoted either to the historical question just discussed or to an examination of the reasons for price inflexibility.[33] Monopoly power (as I use that term in this article), inherent in fewness of competitors, seems to be the only reason mentioned by Means for the existence of "administered" prices.[34] He recognizes that varying degrees of amplitude of price change during depression may be due to differences in conditions of supply or demand as well as to differences in the degree of competition or monopoly, but the influence of different conditions of supply or demand is not analyzed. Tucker, on the other hand, seems to deny that competitive and monopolistic elements have anything at all to do with the matter, emphasizing differences in demand conditions and in cost conditions as the true explanations. I should say that in most cases a *necessary* condition for a high degree of price inflexibility — both infrequency of change and small amplitude of change — may be found either in the existence of monopoly power or in a combination of fairly constant marginal direct cost with high inflexibility of wage rates and prices of materials and services which make up the direct costs. For obvious reasons neither of these conditions is sufficient,[35] without other elements, to explain price rigidity, although the coexistence of the two conditions is not necessary. Among the more important of the contributing elements are type and durability of product, which may affect both the degree of shift and the elasticity of demand, preoccupation with average costs rather than marginal costs, calculation of profits over long rather than short periods, and changes in uncertainties.

Whether or not inflexible prices have become characteristic in

[32] Both these points are made by Mason in "Price Inflexibility," pp. 53, 64.

[33] The reasons for price rigidity have been treated in some of the articles mentioned above and also in the following: J. K. Galbraith, "Monopoly Power and Price Rigidities," *Quarterly Journal of Economics*, L, 456 (May 1936); R. C. Wood, "Tucker's 'Reasons' for Price Rigidity," *American Economic Review*, XXVIII, 663 (December 1938).

[34] Means evidently adopted the terms "administrative" competition and "administered" prices to avoid the use of the word "monopoly," which in the popular mind has legal connotations.

[35] Cf. Galbraith, *op. cit.*, 458.

a part of the economy now in some sense larger or more important than formerly, it is plain that they are now so widespread that their relation to the cycle and to the long-run level of use of resources is exceedingly important, although few persons have attempted to study it and no one has gone far into the problem.

Means regards the presence of inflexible prices as a seriously disturbing influence tending to aggravate the severity and duration of depression, once it has been initiated by changes in the supply of money with relation to the demand for it, by changes in the relations of savings and investment, by changes in the relations of prices, costs, wages, and profits, or by any other cause. He does not, however, demonstrate convincingly how and why inflexible prices are a disturbing influence. His conclusion appears to proceed from (1) a belief that tendencies to depression would be overcome if all prices, including the rates of pay of variable factors, were "perfectly" flexible, in some undefined sense, and (2) a sketchy discussion of some of the proximate consequences of a policy of inflexible prices by an individual firm or industry.

The proposition that "perfect" flexibility of all prices would overcome tendencies to depression is not stated explicitly as the view of the author. Rather, it is set forth as a logical implication of the theories of classical economics, and a view upon which laissez-faire policy has been based. Although Means does not say whether or not he believes this proposition to be correct, he must in fact consider it correct if he intends to use it in showing that inflexible prices exert a disturbing influence. If it is held that flexibility of prices exerts a preventive or remedial influence it may be reasoned that inflexibility exercises a disturbing influence; but the latter conclusion cannot follow from the position that price flexibility does *not* tend to minimize depression!

Is the proposition that "perfect" flexibility of all prices would prevent depression true? The argument is that, given such flexibility, influences tending toward depression would spend themselves in changes in the general price level, leaving price relations unaffected — except for changes reflecting different trends in costs or shifts in demand between commodities — with the result that production relations would remain essentially undisturbed, and total employment and real income would be unimpaired. Disparities in price flexibility due to differences in the degree of monopoly, which upset price relations, thus seem to be a major obstacle to the continuous full use of resources. Now it is surely

time to stop the dangerous pastime of exhuming the classical economists to force from them universal truths to use upon problems to which they, in an easier life, paid little attention.

According to Means's interpretation of the implications of classical economics, flexibility of all prices could preserve full use of resources even if the community tried to save more than would be invested.[36] Reflection seems to show, however, that the most perfect price flexibility imaginable would not be able to preserve full use of resources in the face of an attempt to save more than would be invested, unless most of the people in the community — business men and savers especially — had an implicit faith that price readjustments would in fact always maintain conditions such that it would be less advantageous to hoard than to spend, to refrain from borrowing and investing (whatever amounts were appropriate for full use of resources) than not to refrain. The purest of pure competition in all markets, including factor markets, would guarantee no such expectations. There could be marked fluctuations in investment in durable goods without compensating changes in spending on non-durable goods, and disturbances incident to transfer of resources between durable and non-durable goods industries.

In general, the truth or falsity of the proposition that some degree of price flexibility in all markets would insure continuous full use of resources cannot be demonstrated except with reference to some particular kind of economy in terms of types of cost structure and income structure, degrees of durability and specialization of products, elements other than prices which affect expectations, and so on. The effects of a high degree of price flexibility, assuming it to be attainable whatever the type of economy, are likely to differ in an economy where most costs are overhead from the effects in an economy where most costs are variable. Similarly, price relationships may exercise much more influence on the degree of use of economic resources in an economy where most products wear out quickly than in one containing many durable products. Again, the effects of price relationships may be different in an expanding economy from their effects in an economy characterized by a strong tendency to stagnation. Means does not really analyze the probable effects of widespread price flexibility in the modern economy.

When it comes to a discussion of the effects of individual in-

[36] *The Modern Economy in Action*, pp. 68–70, 114–115, 121.

flexible prices the analysis is inadequate to demonstrate the conclusion. To hold that with a drop in demand an inflexible price will result in diminishing employment and payrolls in a given firm or industry, and hence in reducing demands for other goods, sounds plausible only as long as one fails to consider elasticity of demand for the product of that firm or industry and overlooks the fact that only a part of the gross revenue goes to labor. With a demand that was inelastic (after its move to the left) a lower price would bring in less total revenue to the industry. It would, however, leave purchasers more of their incomes to spend on other things. An analysis of the effects of inflexible prices on the length and severity of depression must deal with questions of differences in elasticities of demand and the corresponding effects of these prices (as compared with lower prices) on the demands for other goods, on the revenues of different firms and industries, on the distribution of revenues between labor, investors, and corporate treasuries, on business spending, and on hoarding.[37] Means does not present an analysis in such terms. Another limitation of his analysis is the failure to make clear the relative significance of frequency and amplitude of price change.

Finally, although he seems to believe that disparities in price relationships constitute a major obstacle to the continuous full use of economic resources, Means has not attempted to define any norm of price relationships which would produce a continuous high level of performance in the economy. Nor, so far as I know, has anyone else.

THE ISSUES

At this point I wish to summarize briefly several points made in the foregoing pages and a few which appear later. (1) Although economic theory has aided greatly in discovering the important questions to ask about industrial organization and business policies, it has not yet developed many concepts which can be used fruitfully in the analysis of the facts in this field. (2) Comparisons of the results of pure or perfect competition with the results of oligopoly or of monopolistic competition are scarcely more illuminating for questions of public policy than their less sophisticated parents, those contrasts between the results of "competi-

[37] See my article "Monopoly Prices and Depression," in *Explorations in Economics*, and John D. Sumner, "Public Utility Prices and the Business Cycle," *Review of Economic Statistics*, XXI, 97ff. (Aug. 1939).

tion" and of "monopoly" whose extensive textbook wanderings were nearly as aimless as they were dreary. (3) According to the diagnoses of many economists writing on public policy in this field, monopoly elements in industry have yielded increasingly unsatisfactory results, until the situation is now intolerable, but these writers have not demonstrated the extent to which undesirable results are actually due to monopoly. (4) Elements of competition and elements of monopoly are not the only forces in industrial markets which critically affect results. The search for causes, both of desirable and of undesirable results, must throw off the blinders which have too often kept it coursing up and down the alleys marked "too much competition" and "too much monopoly." It is necessary also to examine the types of fluctuation in demand, the cost conditions, uncertainties about future demand or costs or the actions of others, the channels of distribution, the state of progressive improvement, and other elements. (5) Existing theory provides few norms of desirable results for work in this field. Such norms can be developed only by giving content and particularity to broad value judgments through further theoretical work and extensive factual study. Study of actual conditions in the market and of policies is imperative, and in many instances factual study of results will be necessary to discover their true relation to norms. (6) The programs or proposals for public policy examined in the last section do not rest upon a foundation of clearly defined norms and study of the facts of market results measured against these norms. Those who now take a positive stand of any sort on public policy with respect to big business and industrial markets must do so on a basis of faith rather than knowledge of market results, or on broader grounds of the relations between concentration of private power and political and economic democracy. (7) Wages, unemployment, labor organization and policies, and the broader aspects of work conditions are often intimately related to the behavior of investment, output, prices, and profits. These things should be studied together, especially in monographs on particular industries or groups of industries.[38] (8) The issues in the field of industrial markets must be related in much clearer and more effective fashion to questions of trends and cyclical fluctuations in the level of use of economic

[38] Few studies of particular industries which go beyond mere description have attempted to treat these two sets of things. One of the offenders in this regard is my own book, *Market Control in the Aluminum Industry* (Cambridge, Mass., 1937).

resources and in income in the whole community, and to allied problems in the spheres of monetary and fiscal policy, international relations, agricultural and public utility markets, and the like. (9) Formulation of public policy requires examination of alternatives as well as condemnation of the existing scheme of things. Since most alternatives involve changes which would, if made, present political and administrative problems to government, and often to business and labor, it is obvious that the political aspects of alternative arrangements need thorough analysis. Indeed, the need for close coöperation between economists and those well versed in political science and administration (with respect to business and labor as well as government) is so patent that the wonder is the general lack of it.

Acquaintance with the work done in this field by economists, government officials, business men, and others leads to the conviction that there exists at present no body of knowledge adequate to support a comprehensive program of public policy of *any* sort toward industrial markets. The best that we can hope for in the immediate future is that what knowledge we have will be used to avoid mistakes in policy and to make a few constructive changes.

It appears that there is no general agreement, even among economists, on a central set of issues in this field, to say nothing of diagnoses and proposals for policy. The first task, then, is to define the issues, to assess the present state of our knowledge about them, and to see what can be done to improve it. To that endeavor this section is devoted.

Putting aside the broader question of the conditions necessary for political and economic democracy, let us set out the more narrowly economic issues on the assumption that a high degree of efficiency in meeting the freely expressed wants of the community of people and a lessening of inequalities in the distribution of income are desirable ends. From the standpoint of their direct relation to economic welfare, industrial structure and business policies are thus to be judged by their effects upon efficiency and progressiveness in meeting the wants of the people with respect to goods and services produced and available jobs and conditions of work, upon the severity of the business cycle, and upon the distribution of income. High efficiency in the use of the economic resources of a community means several things. The sizes of firms must not depart far from those necessary for

minimum cost and continuous progressive improvement, and location of plants should be such as to minimize total costs, including transport expense. Idle men, idle equipment, and idle savings must be kept at a very small minimum. Resources should not be devoted to uses which yield no product of value to anyone. Resources should be allocated between different uses in a changing pattern such that the worth to the community of similar units of resources (e.g., men of about the same abilities, dollars of savings) tends to be not greatly different in different uses. In other words, there should be a strong tendency for resources to be so allocated that the satisfaction of peoples' wants (given the money incomes which they have) could not be markedly improved by transferring men or material resources from one use to another. Although it seems probable that, in the absence at least of much more central control of the economy, technological advance will always be accompanied by periodic fluctuations in investment, incomes, employment, and consumption, it is also probable that the severity of the cycle can be diminished without lessening the rate of economic progress. Hence it is important to learn, if possible, how present industrial organization and business policies affect the business cycle. Finally, the effects upon distribution of income may be important.

These issues may be grouped as follows:

1. size of firms in relation to efficiency and economic progress and locational factors;
2. allocation of economic resources between industries, utilization of resources already invested, returns to their owners;
3. the level of use of resources in the community as a whole;
4. severity of the business cycle;
5. progressiveness.

Progressiveness is so closely related to other issues that it will be convenient to discuss it piecemeal in treating them.

Size and Efficiency

Perhaps the most ridiculous aspect of our public policy toward industrial organization is that we have permitted the growth of giant corporations without bothering to try to determine by an examination of the facts whether they are more efficient units of production and marketing than somewhat smaller enterprises. Law has placed few restrictions on size or on the share of the

market which may be obtained by merger or expansion. Further, it is obvious that the state corporation laws, and the interpretation of the Sherman Act to prohibit agreements, have facilitated and encouraged growth in the size of corporations. This growth has tended to diminish equality of opportunity, and few would contend that it has operated to lessen inequality in the distribution of wealth and income. It has enhanced the concentration of economic and political power in a general sense, and it may have multiplied the number and strength of monopoly elements in the economic system, thus augmenting potential divergences from the most efficient investment policies, volumes of output, and price policies. There seems to be no sensible reason for permitting the existence of firms larger than the smallest size required for the attainment of high efficiency in production and marketing and in the highly important work of research and application of improvements in products and processes. Yet factual study of the relations between size and efficiency and progressiveness has been almost nonexistent, although striking growth in size began more than fifty years ago.

Merger or expansion is not to be explained wholly, perhaps not chiefly, by a quest for economy. There are several other powerful motives: promotion and banking profits; increase of monopoly power through attainment of greater size, through added power to weaken or to scare off competitors, through possession of larger resources for national advertising, through acquisition of scarce raw materials, or through ability to make contracts for large sales to large users; greater security with respect to financial resources through tie-ups with powerful banking houses; desire on the part of management to run a giant concern and wield great power; or the mere feeling that growth in itself is a value.

Nor does the continued profitable existence of great corporations selling in somewhat the same markets as smaller enterprises demonstrate that the efficiency of the former is greater than or even equal to that of the latter. The profits of the larger firms may be explainable simply by the exercise of monopoly power. Entrance of additional firms or the growth of smaller, more efficient companies may be prevented by fear of the consequences should they begin to compete on the basis of efficiency, by lack of resources sufficient for extensive national advertising, by inability to obtain scarce raw materials in possession of the larger firms, or by other barriers. Moreover, even if a great corporation is so

inefficient as to gain little or no profit on original capital, it may long continue its cretin-like existence undiminished in physical stature, although its financial clothes, shrunk from successive trips through the wringer, cover less and less of its oversized body. Management, when differentiated sharply from investors, may decline to consider reduction in capacity as long as money can be obtained for replacement of equipment.

On the other hand, in some industries many firms may remain too small for maximum efficiency because their expansion is checked by the expenses of selling. The costs of giving consumers accurate knowledge about the products in the market sufficient for rational choice are, of course, necessary for maximum efficiency in meeting their wants. But when competition becomes a contest in advertising extravaganza, and sales expenditures mount beyond this minimum necessary for efficiency, the result may be that many firms find themselves limited by rising costs of selling to a size less than that appropriate for maximum efficiency.[39]

In summary, it may be that many of our present industrial corporations are much larger than they need to be for efficiency. Perhaps a considerable degree of dissolution would increase efficiency in some industries, or at least leave it unaffected. In some industries there may be a very wide range within which cost is not appreciably affected by change in size — a range so great that the numbers of firms in the industry could be doubled or tripled, or, if concentration had been hampered, cut in half or in thirds, without any appreciable effect upon efficiency once the new units had adapted themselves to the altered situation. On the other hand, one may well be skeptical of Simons' apparent view that atomization sufficient to restore effective competition would not markedly reduce efficiency in many industries, and of the somewhat similar notion expressed by Assistant Attorney General Robert Jackson and Thurman Arnold that the maximum size necessary for efficiency is typically below the size required for price control.[40] An interesting view which probably has more validity is contained in the acute observation of Burns that in several industries much more attention has been paid to economies of great-scale production than to the possible economies available to the medium-

[39] See Edward Chamberlin, *The Theory of Monopolistic Competition*, 3rd ed. (Cambridge, Mass., 1938), p. 166.

[40] *Report of the Attorney General for 1937*, p. 99; Arnold's speeches (mimeographed), June 15, 1938, p. 11; August 19, 1938, p. 12; Sept. 3, 1938, p. 9.

sized firm.[41] The plain fact is that, although programs of policy are constantly advanced upon one presumption or another with regard to the relations between size and efficiency, we know very little about the facts of the matter.

Studies of profits, as shown in the accounts of corporations, have indicated appreciable differences in the rates of return on capital for firms of different size in the same industry. One fact typical of many industries is that the highest rates of return are reported by the medium-sized corporations. It is extremely doubtful whether anything can be inferred about the relations of size and efficiency from studies of reported profits. Differences in book profits may result mainly from differences in accounting policy. The largest firms are probably more hesitant to show large profits for fear of government investigation or political attack. The smallest firms often keep inadequate accounts based on dubious principles. Accounting practices differ in the same industry for other reasons. Moreover, firms of different size regarded as being in the same industry may not produce exactly the same range of products or quality of products, or may not sell in exactly the same set of geographical markets. For example, the largest electrical equipment firms make both heavy equipment and a variety of lighter appliances, while many smaller firms restrict their activities to the lighter equipment. Specialization according to quality ranges is important in some clothing industries. Products of the "big four" meat packers are distributed throughout the country but many smaller firms sell in local markets only. Large buyers, who can often exact lower prices, may deal only with the largest firms, as was apparently the case for a time in the rubber tire industry.

Studies of the relations between size and efficiency must concentrate on costs. Formidable difficulties are obvious, as is true in the case of nearly every important economic problem. Some of these may be noted here. The development of accounting standards differing somewhat from those in use is probably necessary, because even the best principles of accounting designed for the legitimate purposes of private business are not entirely adequate for all social purposes. Examples of this are found in the problems of how to treat the costs of old equipment with respect to depreciation and obsolescence, and changing price levels. Secondly, in so far as comparisons are made between the costs of

[41] *The Decline of Competition*, p. 525. Cf. Nourse and Drury, *op. cit.*, Chap. IV.

existing firms of different sizes many complexities must be faced. Differences in costs of materials or in rates of wages or interest must be examined to see if they reflect true differences in efficiency or something else. The larger firms may incur some sorts of expenses which are not related to efficiency, such as expenses of "publicity" designed to ward off political attack or government investigation or blackmail threatening private suits. Comparison must be restricted to firms selling nearly the same range of products in the same geographical markets unless techniques are available by which adequate allowance can be made for differences of these sorts. The problem of allocating common expense among a variety of products intrudes here like one of Högfeldt's slippery thousand-leggers. Imposing difficulties such as these should not deter efforts to reach the best possible conclusions on the relations of size and efficiency and the use of these conclusions in shaping public policy. It must be remembered that executives of big corporations are constantly making decisions which substantially affect economic welfare upon problems involving very great difficulties in reaching tenable conclusions. Those who urge that government should act only upon precise certainties are actually advocating inaction.

Thirdly, unless adequate cost information is voluntarily made available by business men to students of this problem, it can only be secured by government. And, in any event, study of the relations between size and efficiency in any considerable number of industries could be accomplished within a few years only if carried out by large research foundations or by government agencies.

One reason for advocating the largest number of firms in each industry which is consistent with efficiency is the probability that the greater the number of competitors the stronger the incentives of each to make innovations in product, processes, or equipment, other things being equal. The most important thing which we are not entitled to consider equal without studying it, however, is the relation between size and efficiency in research — i.e., in the work of discovering improvements and adapting them for commercial operations. On this matter even less is known, if that is possible, than about the relations of size and efficiency in production and marketing. Are there wide limits within which the sizes of research staff, laboratory, and research funds are unimportant in their effect upon quantity and quality of results per unit of expenditure? Are the talents of "key" research men so scarce that

the question of size is of little significance? Can results comparable to those secured by giant corporations be obtained by coöperation in research between large firms, or between small firms? There is as yet no proof that research by big business is more or less productive in progressiveness than that of smaller companies. Certainly the very great importance of rapid progressiveness makes it imperative to learn all that is possible about the relations between size and productivity in research. For this task coöperation between physical scientists and economists seems indispensable.

The most efficient size for a business unit obviously bears a close relation to locational factors. Here the main problems seem to be concerned with distinguishing those factors influencing location which contribute to the most efficient balance of size and of transport expense from others that may have the opposite effect, such as some forms of basing point or zone pricing systems, or artificial barriers to some raw materials or to markets.

Allocation of Resources, Utilization, and Incomes

The second set of issues concerns the allocation of economic resources between firms and groups of firms (markets or "industries"), the degree of utilization of resources already invested, the kinds of products offered in the market, and the incomes of the factors of production. These include the issues which have been typically regarded as the monopoly problem. As we have seen, in refining the notions of competition and monopoly and emphasizing the variety of possible market results with a given blend of competition and monopoly, as well as with different mixtures, the theory of monopolistic competition has indicated the need of extensive factual study of several questions connected with these issues. In many instances direct study of market results will probably be necessary, and it is clear that norms of desirable results must be formulated in terms of relationships which can be measured from data of sorts that can be made available.

If differentiation is neglected, it is not difficult to formulate abstractly a norm of maximum efficiency in the use of economic resources in a community, on the assumption that all resources are used (at conventional or legal rates of use). Maximum efficiency would exist when resources were so allocated between different uses that new investment in homogeneous resources ex-

hibited expectancies of equal returns in all uses (equal net returns after allowances for risk and other elements affecting relative attractiveness), and when the output of each firm was always that for which price was equal to marginal cost. Since adequate consumer knowledge is not costless, and since progressiveness seems to be the only way in which great numbers of people can be lifted out of poverty, the statement of the norm must be understood to mean that in each market resources are invested in the imparting of true knowledge and in the work of discovery and introduction of improvements in product and processes up to the point where new investment of homogeneous resources is expected to earn equal returns everywhere and returns equal to those which the resources could earn in other uses such as production or transportation. (I raise no questions here about divergences from such an allocation of resources which are desirable on grounds other than that of pure economic efficiency.) The norm can also be widened to include organization of resources in units of the most efficient size for production, marketing, and research, located most efficiently. It goes without saying that if abstract notions of equilibrium like this are to be of real use they must be so conceived as to recognize that different time periods are required in different situations for the spread of knowledge, the adaptation of innovations, reorganization of resources, and the like.

The practical problems are how to discover the extent of departures from the desirable quantitative relations just described — i.e., departures that are persistent and of sufficient magnitude to be worth bothering about — and the reasons for divergences. This requires practicable measures of overinvestment and underinvestment of economic resources, of overproduction and underproduction, of inequalities in incomes of homogeneous resources. Methods of measurement that are entirely satisfactory have not yet been developed. I mention such an obvious matter as the need for study of the reasons for divergence only because there is a disposition among students in this field to think that the reasons are usually to be found in monopolistic or competitive forces, whereas other elements may be important causes of divergence. Examples may be found in the discussions of inflexible prices and of "ruinous" competition.

The essence of the most desirable allocation of resources is equality in worth to the community of increments of homogeneous resources in all uses. Few attempts have been made at empirical

study of the allocation existing in a given period, although studies of business profits and other incomes have disclosed differences which have sometimes been interpreted as a symptom of divergences from the best allocation. Comparison of the rate of return on capital with an actual average or with some notion of a "normal"[1] return has been a common method used in attempts to ascertain the results of monopoly and in the regulation of public utilities. Recently the increasing use of the concept of marginal cost in theoretical work has led to the appearance of Lerner's measure of monopoly power, the ratio of the difference between price and marginal cost to price $\left(\frac{P - MC}{P}\right)$.

Apart from practical difficulties in the measurement of profits and of marginal cost, which are probably not insuperable, there are several difficulties with both these methods as instruments of measuring divergence from the best allocation of resources or the best rates of output with existing resources. They are not, in fact, *measures* of the extent of divergence. At best they are merely indicators of the existence of some divergence. Abnormally high returns to capital in a given firm or market imply either underinvestment or underproduction or both, without revealing which situation exists. Returns equal to the appropriate average or "normal" returns do not signify the existence of the right amount of investment, for they are quite consistent with overinvestment, high prices, and much unused capacity. A price above marginal cost denotes the presence of monopoly, to be sure, but the degree of monopoly according to Lerner's measure tells nothing about the extent of restriction of output (i.e., how much greater output would be if price were equal to marginal cost) or about the existence of overinvestment or underinvestment.[42]

[42] A high degree of monopoly according to Lerner's measure would seem to connote large profits or large restriction, but the measure itself would not indicate which of these conditions obtained. With a given amount of investment the less elastic the demand, the higher the price and the profits, but with inelastic demand between price and marginal cost the amount of restriction would not be large. In the situation characterized by overinvestment and ordinary profits (the demand curve for the firm being tangent to its total average cost curve) the less the elasticity of demand, the higher the price and the greater the restriction. But demand curves with quirks in them might produce different results. For instance, suppose marginal cost was nearly constant for a long stretch, and that demand was pretty elastic for less than half this stretch, then dropped abruptly and continued very elastic quite close to the cost curve for the rest of the stretch. The degree of monopoly by this measure would be the same as with a smooth demand curve through the same price point, but restriction might be much greater with the quirky curve.

As long as it is impossible to ascertain demand at prices in a considerable range below and above those charged, it will, of course, be impossible to measure precisely the extent of underproduction or overproduction, of underinvestment or overinvestment. Public policy designed to improve the allocation, organization, and utilization of resources must rely, as business men have to, on the best possible estimates of demand conditions and their probable changes. It should be obvious that neither the method of comparison of profits, and of other incomes, in different markets, nor Lerner's "measure" would by itself show the extent of the changes in allocation and utilization that would be desirable. To avoid mistakes, each would need to be used in conjunction with estimates of demand and to be applied in terms not of past results, but of future expectancies. However, the most serious limitation of each of these two methods as a guide, by itself, to public policy is that it would not even be a sure guide to the *direction* of the desirable change in allocation of resources as between particular firms, markets, or industries. Neither of the methods is a certain indicator of the presence of overinvestment or underinvestment. If allocation of resources were altered, or left unchanged, by the use of either the criterion of equalizing returns or that of equalizing the degree of monopoly in all markets (as apparently advocated by Lerner and Meade),[43] without consideration of the degree of utilization of resources, in many instances the situation might be made worse rather than better, or substantial divergences might remain uncorrected. Where high returns resulted not from underinvestment but merely from restriction in the form of poor utilization of existing facilities, and perhaps of labor, additional investment would create overinvestment. An allocation left unchanged because returns were equal might embody marked overinvestment in some sectors, where monopoly expressed itself in poor utilization, and hence underinvestment in others.

Equalizing the degree of monopoly, according to Lerner's "measure," through a process of increasing the relative amount of resources invested in markets where the measure was higher than average, and diminishing the relative investment in markets where the index of monopoly was lower than average, might enhance overinvestment and the quantity of idle, wasted resources

[43] Lerner, *loc. cit.*; J. E. Meade, *An Introduction to Economic Analysis and Policy*, American edition, edited by C. J. Hitch (New York, 1938), p. 189.

in many markets. A high degree of monopoly in markets where entry had been largely unobstructed and profits were not abnormally large would mean that overinvestment of capital, accompanied perhaps by underinvestment of labor, existed relative to markets with a low degree of monopoly. The allocation of capital should actually be changed in just the opposite direction from that suggested by use of Lerner's "measure." He overlooks the importance of the conditions of entry. The use of either of these methods alone as a guide for allocation of resources implies that underutilization is never important, or that, if it is significant, nothing can be done about it, so that changes in allocation afford the only method of equalizing the worth of like resources in all uses.

If used as the sole criterion for allocation, equalization of the degrees of monopoly in all markets would have other serious defects. It would legitimize prices higher than costs in all cases where monopoly elements happened to exist, whether or not monopoly in particular cases had any justification. Yet clearly public policy should be directed toward eliminating or sterilizing monopoly power in all cases where it holds no promise of desirable results of any sort but only of very undesirable consequences. Secondly, to reallocate resources according to an index of degrees of monopoly would entirely overlook other causes of overinvestment or underinvestment. Of two firms or markets with equal indices of the degree of monopoly, one, in a new "industry," may be underinvested on account of the slow spread of knowledge and innovation or existence of large uncertainties, while the other is overinvested because of poor estimates of growth of demand or a downward shift in demand. There may be many reasons for overinvestment or underinvestment other than "too much" competition or the presence of monopoly elements such as fewness of sellers, control of scarce materials, agreements, patent pools, and the like.

Plainly questions about allocation, utilization, and incomes cannot be illuminated by any simple measure. A combination of the methods of comparison of incomes and of the relations between price and cost could be used successfully in most cases as a device for detecting the probability of large or small divergence of market results from the most desirable. An alternative method of revealing the probability of little or of great departure from desirable results is the examination of all the important objective conditions in a market and of the behavior of firms. But partly

because these methods can never yield more than a rough guess at the market results, and partly because it is probable that the objective market conditions often leave to the executives of a firm a considerable range for subjective choice of policies, it is plain that in many cases intensive study of the relations between investment, output, employment, prices, costs, incomes, and conditions of entry will be required if public policy is to make substantial contributions to improvement in economic welfare and at the same time to avoid mistakes. The number of studies of this sort for particular firms or markets or "industries" has been discouragingly small. Yet without many such studies we shall continue to know but little about the extent of misallocation of economic resources, uneconomic utilization of resources already invested, and undesirable differences in incomes to owners of similar resources.

Difficult problems encountered in such studies do not lurk in the background. A few may be discussed briefly. It is necessary to work with concepts that can be measured, but not all measurable concepts are relevant. Physical measures of capacity and output are not of much use unless at least a rough notion of their relations to dollar values can be ascertained, for the problems of allocation and utilization of resources are problems of relative worth to the community.

The problem of allocation is a problem of adjustment over time. In studies of particular firms or markets, averages, as well as measurements for particular short periods, may give erroneous impressions of divergences from optimum investment, unless the averages or the measures for particular periods are carefully selected on the basis of knowledge of the times required for various readjustments, of influences peculiar to that firm or market, and of the time periods used by business executives in planning investment policies.

In the formulation of a norm of desirable results at the beginning of the discussion of allocation, utilization, and incomes, stress was laid on the desirability of improvements that reduce cost, increase quality of product, or adapt a basic product to new uses for which it is more satisfactory or more economical than existing goods. It is conceivable that monopoly power may be used either to diminish progressiveness or to enhance it. If discovery or introduction of improvements is lessened, this will not be likely to reveal itself through study of the market results along the lines

I have advocated. It would seem that this could be ascertained only by inquiry in which engineers and economists coöperate, if at all. On the other hand, large profits from use of monopoly power may possibly result in more rapid progress than would occur with smaller profits, because larger sums are available for research and experiments in commercial adaptation and because they provide a cushion of comfortable solvency sufficient to encourage greater experiments with new methods, new products, or variations of existing products. In other words, it is possible that continuous underinvestment or underproduction accompanied by large profits may continuously yield more improvements than would come with smaller profits. The crucial question here seems to be the extent to which policies of progressiveness depend on the level of profits. An interesting angle of this is the possibility of developing specialist investment companies which would hold a special class of "research" or "improvement" shares of a large number of corporations by which the latter would obtain from the savings market abundant funds for research and commercial experimentation.

Two other sets of questions concerning the allocation and utilization of economic resources must be noted. They involve (1) the use of resources in imparting information about products, and (2) the amount of variety or differentiation of product. The two are obviously interrelated. Maximum efficiency in meeting consumers' wants requires expenditure of resources in providing truthful information about the properties of commodities in amounts such that the expected returns to owners of these resources are everywhere equal and equal to the returns which they could expect in other uses. Maximum efficiency also requires as much variety of differentiated products as people really want for prices covering the costs of these products, but no more. In so far as consumers can successfully test products for the attributes which they want, differentiation of sorts that they do not want is not likely to pay, and excessive use of resources in advertisement is not likely to be profitable. For example, wherever manufacturers can subject materials to precise tests showing the relative degree of desired qualities, differentiation (of these materials) of sorts that have no real advantage to them is probably ineffectual, and advertising probably fails to pay for itself if carried beyond the amount necessary to call attention to the product and its true advantages.

The dangers of excessive use of resources in advertising and of an excessive variety of differentiated products, both of which may involve very large wastes to the community, exist in cases where consumers, because they are inexpert, do not know exactly which combinations of attributes they really want in a product, or in cases where they cannot successfully test the goods before or during consumption for the desired combination of attributes (such things as medicines, cosmetics, fabrics, some foods, automobiles, and refrigerators may serve as examples of one or both of these conditions). If advertising activities were limited to telling the whole truth about attributes of products that are significant to consumers, it would tend to lessen both the danger of more differentiation of product than people want and the danger of excessive use of resources in advertising. Although some advances have been made recently in this direction, such as the work of the Federal Trade Commission under the Wheeler-Lea Act, much still remains to be done. Consumers' coöperation in the provision of knowledge and government information services represent devices to promote this objective that are alternative or supplementary to the control of private enterprise.

Even assuming that consumers were provided only with the proper knowledge about the products in the market, and also that differentiation did not persistently yield any monopoly profits, there would still remain the perplexing question of how to conceive the optimum variety of differentiated products. This is a problem of considerable importance in the realm of public policy because people very evidently do want some degree of differentiation and because government policies may permit too much differentiation or prevent enough variety. Government in attempting merely to protect people from harm may unwittingly impose undesired standardization, or it may fail to recognize the problem of too much differentiation. If people could have any amount of variety of differentiated products without any reduction in the quantities of physical units of product produced and consumed, there would be no problem. This would be true only if the costs to a firm of producing a differentiated product were the same for equivalent volumes of output as the costs of making an undifferentiated article, and if the total average unit cost did not vary at all with changes in the rate of output — in other words, if the firm's cost curve were a straight horizontal line, whether or not it produced a differentiated product. Obviously, the second con-

dition is not found in practice even if the first sometimes is. Ordinarily each firm selling a differentiated product finds that its market is limited by the existence of other varieties of the same general product. If competition between such close substitutes is strong enough not only to eliminate abnormal profits, but also to force prices to the lowest figures consistent with minimum profits necessary to obtain the entrepreneurial services, each firm will still be producing less than the volume which would give it minimum production costs. Its capacity will not be fully used. Prices and costs will therefore be higher and the quantities of physical units consumed smaller than they would be in the absence of differentiation. Consumers cannot have both maximum efficiency in production and this amount of variety. The only way to get larger production and lower prices would be to diminish variety. This norm is closely related to that called "a sort of ideal" by Chamberlin.[44] The difficulties of applying it where sellers of differentiated editions of a general product are few would be formidable. Moreover, perhaps consumers really would prefer less variety if such a condition were brought about. The Chamberlinian analysis suggests that they would not, but theoretical work on the problem has not yet resolved the questions involved. In this problem, psychological aspects intrude themselves more bluntly than in other economic problems — where they may, in fact, be quite as important. Study of the problem by economists and psychologists together might clear away some of the doubts.

Trends in the National Income and Employment

Plainly, the problems just discussed are in the present conjuncture subordinate in importance to the problems connected with the general level of use of resources in the community as a whole. Unless we can move persistently toward a much higher use of men, equipment, and savings it is questionable whether democracy and freedom will long remain more than empty slogans. (And, one might add, with dictatorship the questions of allocation of resources and distribution of incomes will be settled according to principles that bear little resemblance to those discussed above.)

[44] I have assumed here that the right amount of true knowledge about products is disseminated by one or another means. Chamberlin assumed perfect knowledge on the part of consumers without raising any questions about the methods or costs of dissemination.

Although questions of the relations of industrial organization and business policies to the level of use of resources are closely connected with those concerning allocation and utilization, which we have just examined, I think they can profitably be distinguished. The matters just discussed concern (1) the achievement of balanced investment of resources between different uses irrespective of the level of use of resources in the whole economy, and (2) the attainment of the highest possible utilization of resources already invested in a firm or industry irrespective of any effect on the amount of resources used elsewhere. In other words, we have reasoned as if use of an increment of resources in one firm or industry meant either that an equivalent increment was withdrawn from use elsewhere, leaving the general level of use unaffected, or that the amount of resources used elsewhere was unaltered, so that the general level was affected merely by the change within the one firm or industry. Now we turn to the question whether changes in the structure or policies of a single firm or of a group of firms can raise or lower the general level of use of resources in the whole community by *more* than the amount of the change in its own market. To signalize the critical importance of raising the level of use of resources is not to imply that their allocation is of no significance. Whenever there are real alternatives in the use of resources the problem of allocation exists. It must be recognized, however, that in some instances there may be, for a considerable period at least, only one use in which certain men or funds can in fact be employed; and that, whenever there are unemployed resources, the effect of corporate policies on the rate of use of resources elsewhere in the economy may be much more important than their effect in altering the marginal worth of resources in a particular market compared to their worth in other uses.[45] Employment of more men and funds in building new locomotives to replace engines not yet obsolescent (with standard wages and prices of new locomotives) would doubtless lower the marginal worth to consumers of such resources in this use; but it would be worth while to the community if it resulted in a considerable net addition to employment and output elsewhere in the economy. Other uses for these men and funds would, of course, be worth more to the community if they brought a larger net addition elsewhere.

[45] In fact, the real worth to the community of adding or subtracting resources in a particular market is partly a function of the effect on the level of use of resources elsewhere.

Several questions concerning the relations of corporate structure and policies to the level of use of resources are similar to questions about their effects on cyclical fluctuations in the level of use, but again a distinction seems fruitful. Recent emphasis on the danger of long stagnation at a low level of total output suggests that, with or without marked cycles, the difficulties of the ascent to full use of resources may increase as we climb. If so, long-range policies are involved which probably hold a different variety of possibilities than short-run policies appropriate to check depression and promote recovery to a pre-depression level still much below the ultimate goal. In long-range corporate programs, policies of investment, progressiveness, prices, output, inventories, and wages are probably integrated as well as can be, so that a considerable change in any one element means changes in most of the others. But in depression, and perhaps also in boom, investment policies may be almost entirely divorced from some other policies.[46] Is it not likely that changes in price relations are much more important in their influence on the long-run trend in the level of use of resources than in their effects on boom or depression? And may it not be that rapid recovery to pre-depression levels may be promoted more effectively by other means than by price adjustments? Secondly, timing of policies is generally considered very important in relation to cyclical fluctuations. Changes in timing of some kinds of corporate policies might aid in evening out cyclical fluctuations even though they did not contribute to raising the average level of use of resources over a period.

In my opinion, the limited amount of work which has been done on the relation of corporate policies to the trend in the level of use of resources and to the cycle has not produced any adequate foundation for public policy, although it has raised some important questions and brought forth some relevant information. What needs to be done in the future? Discussion will be confined mainly to changes in business policies. If it should be found that changes in policies would probably bring desirable results, the question is then whether such changes can best be induced by alterations in structure — such as change in number and size of

[46] Evidence presented in Table II and Chart II of the Statement Submitted to the Temporary National Economic Committee (mimeographed), on May 16, 1939, by Lauchlin Currie, suggests a close correlation between fluctuations in industrial production and in expenditures for plant and equipment by mining and manufacturing firms. The meaning of this with respect to price, wage, and inventory policies, and profits does not appear.

firms or in vertical control, or elimination of restraints — or by one or another kind of government action bearing directly on policies.

The problem of attaining a much higher level of use of resources is essentially a problem of increasing the annual amount of investment in durable goods, both capital equipment and consumer goods. While full use of resources might, indeed, be reached by devoting a larger proportion of them than heretofore to the production of non-durable consumer goods and services, this route would be more difficult and would leave the partially occupied heavy industries for many years a rankling sore that would threaten the tenuous balance of the body politic. Hence, in formulating and studying particular questions implicit in the following brief analysis, especial attention would need to be given to discovery of policies which would improve the use of resources in these industries.

In a broad sense the sort of questions raised below apply to other markets — e.g., public utility markets — as well as to industrial markets. According to estimates presented to the TNEC by Lauchlin Currie, of total gross investment in 1929 mining and manufacturing industries accounted for 19.8 per cent, railroad and utility industries 15.7 per cent, other plant and equipment 21.6 per cent, and housing 19.4 per cent.[47] The corresponding figures for 1937 were 20.0 per cent, 10.3 per cent, 19.3 per cent, and 11.0 per cent. In the absence of great changes in the relative expectations of demand in these different fields, it is evident that increases in investment in one field will raise total investment by a large percentage only if they induce substantial increases in other fields.

With regard to price policies, the general question is, of course, under what circumstances lower prices for a commodity or group of goods, relative to other prices, might result in a better use of resources in the community.[48] It is convenient to distinguish between commodities with elastic demand and those with inelastic demand. This does not involve the necessity of any precise measure of elasticity. All that is necessary is to be able to decide whether a lower price will bring in considerably more revenue and mean considerably larger output and payments to labor and sup-

[47] Currie, Statement, Table V and Chart V.

[48] Questions involved in the relations of price policies to the level of use of resources are treated also in the article by Edward S. Mason in this volume.

pliers of materials, or will yield less revenue and very little greater output, payrolls, and expenditure on materials. In the case of a good with elastic demand, a lower price will mean larger gross revenue to the firm or industry and larger payments to the factors there, but if these increases are entirely offset by shift on the part of the purchasers away from expenditure on other things, there is no net advantage. Under one or the other of two conditions, however, there would be a net gain. The first is dishoarding or use of credit by purchasers so that their spending on other things was not reduced at all or was reduced by less than their addition of spending here. The other condition is that the expenditure on labor and materials to produce the added increment of the good whose price is lowered was made *before* purchasers shifted part of their spending from other articles to this one, and was made by dishoarding or borrowing credit or idle savings. In the first case, there would be an increase in the use of resources outside the firm or industry which lowered its price, as well as in its own market, and this would tend to set up a cumulative upward shift in demands for more and more products. In the second case, this impetus to increased output and employment in other industries might not occur, but it would exist if producers made expenditures, say for new equipment, which brought the total of their added spending to an amount greater than the added increment of revenue diverted to them from purchasers' expenditure on other things. Substantial expenditures on new equipment are, of course, more likely to be made in connection with long-range programs for continuous improvement and expansion than in short-run, piecemeal replacement.

The now trite but unfortunately still timely example of materials and labor for building construction illustrates the probability that, when the prices of complementary materials and services are all lowered together, elasticity of demand for all is much greater than elasticity of demand for any one material or service when the prices of others are not reduced. In general the principles explained above for the case of one article apply also to a group of complementary goods.

Lower prices for goods with quite inelastic demand would not result in much larger total expenditure on labor and materials in their production and would yield smaller gross revenues. However, since purchasers would spend a smaller total on these goods at lower prices than at higher prices, they would have more to

spend on other things, or to hoard. If these additional amounts were spent, demands for other things would move forward and the cumulative chain of impulses to larger use of resources everywhere would be set up.

Up to this point, I have treated wage rates, prices of materials, and technological processes as if they were fixed. In actual or hypothetical cases, no satisfactory answer could be given to the question of the probable effect of lower prices for a firm or group of firms on the general level of use of resources unless some assumptions on these matters could be made. If, because of reductions in wage rates and prices of materials, a firm's total of spending on labor and materials to produce a larger output, to be sold at lower prices, were no greater than the total expenditure of this sort for the smaller output appropriate to higher prices, then there would be *no net addition* to demands for other things because of expanded operations by this firm. Use of more capital and less labor per unit, however, would presumably mean that the firm's increased expenditure on equipment would more than offset any diminution in its total payroll, with a consequent net increase in demands for other things, especially equipment.[40] These possibilities might be more important in the case of commodities with inelastic demand, for it might be much more difficult to secure price reductions on these without reductions in wage rates or prices of materials or technological change.

Another aspect of the problem is the relation between price adjustments and hoarding. Ultimate consumers may save funds intended for purchase of houses, automobiles, refrigerators, or other durable goods which they would spend on these articles sooner if their prices were lower. Unless these funds are spent by others, through intermediaries like the banking system or the investment market, they are hoarded. If others spent them in less proportion on durable goods, use of resources in the industries producing the latter would improve less than it would if the prices of these articles were lower. Secondly, high prices for goods with inelastic demand will bring larger sums to corporations producing them, and smaller payments to labor working on them, than lower prices. Hence, hoarding by these corporations may be greater with high prices. The significance of hoarding of both

[40] Total employment, however, could be diminished initially if the increment of labor employed to make the equipment were smaller than the increment saved by its use.

these sorts, induced by price adjustments, may be greater in depression and in early recovery than it is over a longer period after some recovery has occurred. If study of the question confirmed this surmise, that would constitute a significant qualification to the hypothesis that price relations are more important in long-run trends than in short-period fluctuations.

Study of the problem of the relations of price adjustments to trends in the level of use of resources in a community might be undertaken in either of two ways. An endeavor could be made to formulate a pattern of price adjustments which would be most conducive to full use of resources, and then to discover divergences from this pattern and try to narrow them. The difficulties of this method would obviously be enormous. A better approach is studies of particular market situations to discover a considerable number of them where a probability could be established that lower prices would contribute appreciably to a higher general level of use of resources. This would involve working through the various sorts of possible repercussions noted above.

Several results of price policies on investment have been noted. We now turn to investment policies themselves and their relation to the general rate of use of productive factors. Executives of large corporations which possess some monopoly power may have a considerable range of choice as to investment policies which is widened by separation of management and investors and by close connections with substantial banking houses. The amounts which they invest from time to time in expansion, improved equipment, and replacement can probably vary, without dire consequences, between wider limits than would be possible if competition were keener, if investors could be more importunate or could assume control, or if relations with banking houses were nonexistent. Thus, it is quite possible that total investment over a period is influenced substantially by the choices made by these executives, that it is larger or smaller than it would be if their ranges of choice were narrower.

Full use of available savings may be unattained, not because of a "strike of capital" but because of a stroke of caution among big business executives, which would not be so widespread, even upon the same set of expectancies, if the decisions were made by a much larger number of individuals. There may be a greater degree of sensitivity to investment policies of others when markets contain few firms and the whole number of great corporations is not large,

with the result that the proportion of similar decisions to invest little or much is higher in such a world. Further, is there such a thing as "investment leadership"? Are small firms, or even large ones, influenced to any considerable extent in their investment policies by the actions of prominent corporations? If it should appear that the investment policies of some particular corporations exercised material influence on those of many others, then any change that could be induced in the policies of these leaders would have a "multiplier." In general, it is highly important to learn much more about the considerations and expectations which govern the investment policies of large corporations. This might be a fruitful field of research for the TNEC.

Progressive improvement of equipment, processes, and products is especially important in a period when new industries do not appear, receptiveness of foreign markets has fallen, and declining population growth renders profitable opportunities for expansion of some industries less obvious. Progressiveness enables a given quantity of resources to produce more, which means an increase in the national income, unless the general level of use of resources is lowered, and in most cases it requires investment in new equipment, thus stimulating a rise in the rate of operations in the durable goods industries and a tendency toward full employment. Furthermore, it may aid greatly in making price reductions which tend to improve the level of use of productive factors in some of the ways described above. Indeed, under conditions of the next few decades, continuous technical progress may be the *only* route (short of extensive government participation in industry or a great war) by which our economy can approach full use of resources.[50] Stimulation of industrial research and continuous adoption of improvements should probably be the most important objective of public policy. Industrial research is still quite young, and, according to a number of informants, it has reached a high state of development in only a few corporations. A survey of the present state of research and its economic results and future possibilities, carried out by physical scientists, business men, and economists, might be very illuminating. Such a study should examine the question (mentioned above) of the relations between size of firm, size of research unit, and results; questions of inducements to expansion of research activities and of monopolistic

[50] This view is implied by Professor A. H. Hansen in *Full Recovery or Stagnation* (New York, 1938).

restrictions on introduction of improvements; and the workings of the patent system.

In conclusion, since it appears that monetary policies and "pump-priming" by themselves are not likely to produce full use of resources, it is imperative to ascertain, if possible, whether different corporate investment policies and price policies in various situations would tend toward this goal and to discover means to induce beneficial policies wherever the probability of their benefit can be shown. In such an endeavor, business schools, business men's organizations, and scientific organizations could greatly aid economists and government bureaus if they chose to do so. Study of labor policies of corporations, of policies of labor unions, and of questions of wage flexibility should obviously be closely correlated with study of investment and price policies. It must be recognized, however, that the facts of a social policy probably approved by a great majority of the people in this country set certain limits to the kinds of inquiry which could yield fruit in practicable public policy. The broad principles of the social security legislation, the Wagner Act, and the wage-hour legislation should be regarded as given. Similarly, the main features of the present industrial structure are given data. This means that questions relating to drastic reductions in money wages, destruction of unions, pulverization of industry, and the like, are as pointless as questions of doubling the birth rate or the investment in railroads or otherwise drastically altering the background of circumstances. Those who face these facts must be prepared to reach the conclusion, which seems a distinct possibility, that *full* use of resources cannot be achieved by any combination of practicable monetary and industrial policies and "pump-priming," but only by direct public investment in some industries. This would certainly seem likely if business men and investors should become increasingly successful in enlisting the aid of government in control schemes to protect profits and the value of old investments. In the past, the system of free capitalistic enterprise has made progress by ruthless obsolescence, and it is to be doubted that it can do so in the future by any other means.

The Business Cycle

The final issue to be discussed is that of cyclical fluctuations. In attempts to control the business cycle, the major aim should be to mitigate the severity and duration of depressions without

markedly slowing up technical progress or reducing the average level of use of resources over good years and bad. In the following discussion of the relation of corporate policies to cyclical fluctuations, the reader should keep in mind the various distinctions noted above between the cyclical problem and the problem of raising the trend in the level of use of resources.

Studies of the relation of price policies to cyclical fluctuations involve analysis of the probable effects of lower prices in depression or recovery and lower or higher prices in boom on revenues of firms, on their outlays for labor, materials, and new equipment, on purchasers' expenditures elsewhere, and on hoarding. With respect to depression and recovery, the significant questions are quite similar to those already mentioned in treating the problem of increasing the level of use of resources in the long run. Some important differences may be noted, however. We noticed the possibility that initiation of a *cumulative* impulse to increased total spending in the community might accompany lower prices and larger output only if the firms adopting such policies also increased their expenditures on equipment. The probable extent of additions to equipment would seem to be much less at times when much capacity is unused and in periods too short to work out and carry through broad-scale changes in policy, unless managements could be induced to plan the timing of their equipment purchases to make them more even throughout the cycle. Again, progressiveness generally operates to increase the demand for capital goods and should thus tend toward a rising trend in the level of use of resources, but a higher rate of progressiveness might accentuate cyclical fluctuations unless efforts were made to even out the rate of introduction of new equipment. If corporations were to reserve some purchases for bad years, the results might be very beneficial.

We have seen that, in depression or recovery, lower prices for goods with inelastic demand would leave purchasers more of their incomes to spend on other things and might thus have the result of increasing other demands. Firms buying capital goods at the lower prices might hoard the difference. But consumers would, perhaps, be more likely to spend the difference. If producers of consumer goods with inelastic demand could introduce cost-saving improvements, and reduce prices in depression, this might tend to sustain both the demands for some capital goods and the demands for many consumer goods. On the other hand, lower

prices for goods with inelastic demand might, because they brought less revenue, result in smaller expenditures by their producers on replacement of equipment.

Price adjustments may substantially affect the relative amounts of spending and hoarding in depression, whether or not they exercise much influence in other ways. If price increases "choke off recovery," it must be because they induce greater hoarding, or less expansion of credit, or result in considerable shifts in demands, which create difficulties because of frictions and lags. Study of hoarding by consumers would present great difficulties, but something might be learned from a study of the relations between prices, revenues, and hoarding for large corporations.

Another important matter, which needs more acute study than it has yet had, is the relation between price policies, profits, and reinvestment both in boom and depression. To what extent are fluctuations in investment due merely to changes in profits and to what extent could such fluctuations be reduced by changes in price policies? Another angle of this, which can still bear further examination, is the hypothesis that failure, on the part of any considerable number of large corporations, to lower prices with cost reductions leads to depression via temporarily greater reinvestment, corporate hoarding, or stock speculation, and the failure of consumer purchasing power to increase sufficiently to justify continuous expansion.

Somewhat similar are questions of the relations of price policies and inventories and rates of operation. Are there situations in which the rate of operations both in manufacturing firms and in materials firms could be made more stable by making prices more flexible with relation to the inventory position? [51] A complicating aspect of this question is the speculative element in purchase of durable materials for manufacture or of durable consumer goods. A drop in price often appears to result in a decline in the amount bought, and vice versa. To some extent, this may be explainable by a shift in demand, but there is no doubt that a cut in the price

[51] It is estimated that the proportion of total investment going into increases in inventories in 1937 was more than double the proportion for 1929. (See Currie, Statement, cited above.) Professor Slichter concludes that resistance to higher prices by consumers beginning late in 1936 contributed to the downturn of 1937 because business concerns were slow to adjust their prices, with the result that inventories were too high in the middle part of 1937 ("The Downturn of 1937," *Review of Economic Statistics*, XX, 102, 108, August 1938). It seems probable that the fall in consumer purchasing resulted in considerable measure from the social security taxes.

of a durable good that sets up the expectation of a further drop will lead buyers to hold off, whereas a rise in price may induce larger purchases. It is sometimes maintained that, for this reason, greater flexibility of prices of durable goods would accentuate rather than modify cyclical fluctuations in output, employment, and investment. This contention is highly questionable unless the only alternatives are very little change in price and many frequent small changes in price continuing in the same direction for some time. It would seem that the speculative element could be greatly reduced if large changes in price were made at infrequent intervals, coupled in each instance with an announcement that the new price would not be changed for a particular number of months or years, as seemed appropriate.

D. H. Robertson and Professor Hansen have stressed the fact that, since broad readjustments in the economy are not easily accomplished, any considerable shift in demand between the products of important industries is likely to be attended by depression. Price policies might appreciably enhance the difficulties of readjustment. For example, if a shift in people's demand to an article with inelastic demand at higher prices were met principally by a permanent increase in its price, the reabsorption of resources thrown out of employment by the shift in demand would be made more difficult than if output had been expanded. Such policies in industries like housing and automobiles might precipitate depression from time to time, and tend also to hold down the level of use of resources in the long run.

The principal disturbing element causing the cycle is fluctuations in investment. Within wide limits, price relations may be relatively unimportant in affecting the fluctuations in investment, especially in boom and in depression. If the expectations which govern the flow of new investment are largely determined by elements other than price relations, then changes in the latter would exert little influence on investment, except indirectly by redistributing the flow of funds to be spent or hoarded. It is not wise to concentrate all attention on price policies and price relationships. Study of the investment policies of corporations through the cycle and the considerations governing them may be much more fruitful.

The variations in annual investment of the large corporations may be striking, and it seems likely that policies of recklessness in boom and extreme caution in depression accentuate the cycle. It is doubtful that this need be so. Large corporations anticipate

continuous long life. Aside from financial or control companies, few large corporations now die, although independent existence may disappear in cellular amalgamation. It seems probable that, without endangering life or long-run health, they could plan their programs of replacement, expansion, and modernization so as to regularize their annual expenditures on equipment to a much greater degree than they have heretofore done. By so doing, they could take over some of the burden of compensatory spending and "pump-priming" from government. Mr. Hoover's campaign to induce the corporations to maintain equipment purchases early in the Great Depression might not have failed so miserably if they had held down their investment expansion during the boom and if government had inaugurated compensatory spending in 1930. In any event, it is highly important to learn as much as possible about the course of investment policies of the large corporations through the cycle and the considerations governing them. Again, the relation to industrial research may be emphasized.[52]

Finally, output and inventory policies may not be closely related to price policies for short periods in depression. To what extent do corporations tend to maintain production and employment in the early stages of depression by accumulating inventories? Does this accentuate the amplitude of reduction in output and employment later? Could output and employment be better sustained by coöperative arrangements for accumulation of inventories, with or without government aid?

As in the case of problems of the level of use of resources, study of corporate policies in relation to the cycle must include an examination of the connections between these policies and the labor policies of corporations and the policies of labor unions.

It is possible that little can be done to moderate the cycle or to promote a trend to a higher level of use of resources through changes in the policies of industrial corporations, undertaken by the corporations themselves or induced by government. The compelling necessity to make real progress toward achieving these ends, the apparent weakness of other instruments to advance such progress, and the lamentable lack of knowledge about the possibilities in the field of corporate policies all combine to make study of those possibilities the most important endeavor in the study of industrial markets.

[52] Cf. Slichter, "The Period 1919–1936 in the United States," *Review of Economic Statistics*, XIX, 19 (February 1937).

CONCLUSION

Twenty-five years ago the philosophy and theories underlying public policy toward industry in this country had become crystallized into a simple, integrated structure that was applied in practice, if somewhat ineffectually, through the antitrust laws and regulation of public utilities. Since the war there has been growing dissatisfaction with this policy, especially since the beginning of the depression of 1929. The increasing discontent with the old policy has been reinforced by new developments in economics in the last ten years — particularly the theory of monopolistic competition, work on the determinants of the national income and the volume of employment, and studies of the business cycle — which have gone far to discredit both the norms of desirable results contained in the old theory of "free competition" and the conclusion that these norms would automatically be approximated if competition were kept free from restraints. But the recent work has not yet accomplished much toward redefinition of norms, to say nothing of discovering the extent of divergences from desirable results. Like the children of the immediate post-war years, we are too disillusioned to find the old ideas useful for policy-making, but we have in their place merely a set of untested conjectural hypotheses which, to our dismay, are often conflicting. Plainly, we do not have the knowledge requisite for any comprehensive program of public policy toward industrial structure and business policies.

Extensive factual study is necessary both to define new norms of desirable results and to ascertain the extent of divergences from them and the reasons for such departures, especially because the recent work emphasizes the variety of possible results. This need, and also the need for additional theoretical work, is intensified by recognition of the importance of elements other than monopolistic and competitive forces (as usually conceived), such as uncertainties of various sorts, industrial research and progressiveness, and the influence of durability of product on demand. It is still further intensified by a realization of the variety of the issues and problems, as pointed out in the preceding section. Objectives are to some extent conflicting. The industrial structure capable of maximum efficiency in production may tend to prevent the best allocation of economic resources or to hinder the attainment of a high level of use of resources in the whole system —

even with the most intelligent social control that can be devised. Attempts to improve the allocation of resources may diminish the total national income and employment of resources. Underinvestment which yields high profits may possibly result in more rapid progressiveness than would otherwise occur.

Not only must the error be avoided of interpreting the results in industrial markets as a product entirely of competitive and monopolistic forces; where monopoly is an important cause public policy must not act upon any simple measure of monopoly power or results, because the presence of monopoly power may affect a number of things — structural efficiency, allocation and utilization of resources, distribution of incomes, progressiveness, the business cycle, and the trend in the level of use of resources in the whole community. A desirable balance of results with respect to the different issues is the aim.

Study of the facts about industrial structure and business policies should take several forms. Investigations of particular firms or markets are imperative. Secondly, classification of groups of firms ("industries" or "markets") into several categories according to similarities in cost and demand conditions, mixtures of monopoly and competition, distribution channels, and other objective conditions which are significant for business policies or market results, might serve as a useful basis for continuous study of the important problems. Professor Edward Mason and I are now endeavoring to work out such a classification for manufacturing firms, and it is to be hoped that others will lend their efforts to the same task in this field and in other fields.

Thirdly, some problems may best be studied by an examination of the effects of particular conditions or policies in a number of markets or industries. Important examples may be found in patent problems, other aspects of industrial research and progressiveness, the relations between conditions of entry into a market and overinvestment or underinvestment, the relations of size and efficiency, numerous problems connected with the effects of investment policies, price policies, and inventory policies on spending and hoarding, and the effects of particular trade practices on market results.

Throughout this article I have repeatedly stressed the necessity of studying alternatives with respect to industrial structure, business policies, and types of government action, in order to assess their probable results as compared to the results with existing

set-ups. This is particularly important in the future. It is scarcely to be doubted that we shall not long retain anything that can be called liberal democracy unless government both does the right things and avoids bad mistakes. The margin of tolerable error is much smaller than it was when opportunities for business expansion were much greater and more obvious and the people demanded much less from government.

The alternative types of government action are numerous: education of business leaders and labor leaders; encouragement of consumers' coöperation; information services for consumers, for labor, for investors, and for business men; particular devices to affect particular business policies or labor policies (in general the setting of standards or imposition of prohibitions); alteration of industrial structure or other objective conditions in the market (such as changing the conditions of entry); supervision of collective negotiation between functional groups; direct regulation of investment, output, prices, or incomes; taxes and subsidies; competition by government corporations; public ownership and operation. And there are some halfway stages between the various steps mentioned. Where government assumes the responsibility of bringing about desirable results instead of merely preventing undesirable results, it seems questionable whether regulation of investment or prices or other important market results is likely to be highly satisfactory. Neither the experience with public utility regulation nor general knowledge of human behavior encourages the view that a policy of giving orders to business men on important matters is likely to be superior to government operation or, where conditions of size and efficiency and numbers in the market permit it, government competition. It is plain that the probable results of various sorts of government action will be better assessed if political scientists, government officials, and those versed in business administration and labor administration coöperate with economists in studying them.

In general it is probable that in the field of problems surveyed in this article no spectacular general achievements can be accomplished by a few bold strokes. Progress must be made by piecemeal fitting of particular policies to particular situations, with the constant endeavor to integrate these policies not only with each other but with policies in other fields, such as agriculture, public utilities, money, credit, and public finance, labor relations, and foreign trade.

My pessimism about the present state of knowledge on the problems in this field must not be taken to imply that we do not know enough to make any changes at all in public policy now. More vigorous removal of restraints on competition that clearly have no potential social advantage is highly desirable. In this work the present administration of the Antitrust Division of the Department of Justice seems to be making substantial strides. Efforts should be greatly increased to insure that consumers have better information about the attributes of products, investors better information about investment opportunities, labor better information about employment opportunities, and business men better information about economic conditions. A Bureau of Industrial Economics should be established, with the twin functions of currently collecting, reporting, and interpreting basic industrial statistics, and making a continuous study of the problems presented by industrial markets. Methods should be devised of facilitating industrial research by small or medium-sized firms. Mergers of competing firms should henceforth be permitted only upon a showing, to a competent government agency, of a probability of considerable increase in efficiency or progressiveness not offset by disadvantages. Industrial holding companies beyond the first or second layer in a holding-company pyramid could probably be eliminated without disadvantage, and the prohibition of inter-stockholdings by a natural person in companies selling similar goods in a common market would probably have no undesirable results.

In conclusion, I have attempted to treat the problem of private power only in one aspect — monopoly power in industrial markets. From the standpoint of danger to liberal democracy this manifestation of private power may embody much less of a threat than is contained in the use of private power to control government processes and activities or to affect individuals or weak groups in ways other than through market processes. Great corporations and strong labor unions have power of sorts which can be described as monopoly power only in an esoteric sense, and they influence the course of life in the community in many ways not directly related to their market activities. If we are to know whether they and liberal democracy can be reconciled, we must have much coöperative study of the question by political scientists, sociologists, economists, and philosophical-minded business men and labor leaders.

PUBLIC POLICY OF INDUSTRIAL CONTROL

A. H. Feller

GOVERNMENTAL policy with respect to industrial control is popularly supposed to be poised on a critical point. On the one side lies enforced competition, on the other direct regulation of price, investment, and output. Between these the choice must be made. There are active supporters of each of the alternatives who proclaim the necessity of a choice of one or the other, the two being deemed mutually exclusive. To others, the alternatives appear distasteful in the extreme, since they consider that both have been shown to be futile. A half-century of the Sherman Act is enough, they say, to prove that the competitive system is gone and cannot be revived. Direct regulation is a quagmire in which commissions, courts, and utilities flounder in confusion. Why toss the rest of industry into it? These doubtful ones are inclined either to withdraw the hand of government altogether from economic processes, or to search for a new formula — monetary control, cartelization — which might perhaps succeed.

Many of those who believe in the necessity of a choice find that governmental policy hitherto has been a mass of contradiction and confusion. In one law the government denounces monopoly, in another law it fosters it; it calls for flexible prices and then indulges in price-fixing; it commends efficiency in production and distribution, and then fosters inefficient units through special subsidies and privileges. This charge cannot be altogether refuted, although it would not be difficult to demonstrate that it is too often exaggerated. Yet this very confusion has its advantages — it presents us with a variety of methods and approaches, and furnishes a basis for evaluating the necessity of choosing between the supposed antitheses of competition and regulation.

While the quarrel over methods is intense, it can be said with some certainty that the broad objectives of public economic policy, as now envisaged, can be stated in terms which will find general agreement. We all want maximum production, employment, and pay rolls, the elimination or at least amelioration of pronounced cyclical fluctuations. In achieving this end we want to preserve certain values — a democratic form of government, individual

enterprise, and the mobility of labor. We may assume for the purposes of discussion that the disposition of economic forces is such that governmental intervention of some kind is necessary to achieve these objectives.

It is important to note that the choice of method frequently involves a subtle change of objective. The NRA was thought by many of its proponents to be a means of achieving full employment; yet the prime moving force behind it was the desire to preserve existing investment. As the system developed, the preservation of investment came more and more to the fore. A shift of objective may occur for a variety of reasons — the character of the subject of regulation, the personnel of the regulatory agency, all sorts of temporary circumstances. Nor is it always possible for regulatory agencies to view the objective in the same light. Thus, during a depression, those in charge of the regulation of credit will tend to lower interest rates in order to stimulate business, while those in charge of railroad regulation will tend to raise railroad rates, despite the probable crippling effect on general business activity, in order to protect railroad earnings.

The following discussion is designed as a general survey of the methods now available in the government armory or which could be devised for the modification of the institutional framework of industrial activity. The general limitations of each of the techniques, the latent possibilities of perversion of objectives inherent in some of them, and the adaptability of individual methods to coördinated application with others are briefly indicated. More detailed exploration of these factors is necessary but must, perforce, be left to later study.

ENFORCEMENT OF COMPETITION

We may start with one of the supposed two alternatives — enforced competition typified in the Sherman Act. Three characteristics of that act are significant: it states a generally applicable prohibition against monopolies and restraints of trade, qualified judicially by the rule of reason; it is applied by the courts; it operates from case to case. Since the recent revival of the Antitrust Division of the Department of Justice it has not been quite so fashionable to consider the Sherman Act as a dead letter. Some of the chief mourners at its premature funeral are now willing to suspend judgment until the new antitrust policy has been given a trial. The belief is gaining ground that competition, in at least a

portion of the national economy, can contribute toward achieving the general objectives of a democratic industrial policy. Despite its faults, which have been so often reiterated, the Sherman Act method has advantages which cannot be denied. It reduces governmental intervention to a minimum; the generality of its provisions and the rule of reason permit an unparalleled flexibility of application; the case-by-case technique enables each industrial problem to be considered on its own merits.

The succeeding years will most probably bring about a considerable refinement of this method; for example, numerous procedural difficulties can be remedied, the consent decree further developed. Nonetheless, the antitrust laws have obvious limitations which cannot be transcended. There are areas of the economy where competition, even though possible, may well be undesirable; there are other areas where it cannot be enforced by any type of judicial decree. It is in these areas that we must seek alternative means of control. We can turn first to the supposed antithesis of the Sherman Act — direct governmental regulation.

DIRECT REGULATION

The archetype of direct regulation in this country is the regulation of public utility rates. The prevailing opinion is that this sort of regulation is a failure. If the reasons for failure are analyzed they are found to lie primarily in the valuation problem — the long-drawn-out delays of commission and court procedure, the uncertainties of judicial tests, the crippling effect of the requirement of reproduction cost. If the valuation problem is mitigated, as it might well be through the probable victory of the prudent investment theory, and if procedure were speeded up through such means as the recent Pennsylvania temporary rate statute, direct regulation of public utility rates would be enabled to secure a fair test. But a convincing demonstration of the feasibility of regulation of maximum public utility rates would not prove the whole case for direct regulation. Maximum rates for a legalized monopoly based on a fixed return on investment are more easily dealt with than the allocation of investment and production and the fixing of industrial prices.

Of the major difficulties which direct regulation entails, two may be singled out: the standard to be applied and the administrative task involved. The federal government has made a number of attempts to control price and supply. Under the Bituminous

Coal Act minimum prices are to be fixed so as to yield average cost of production. Under the Agricultural Marketing Agreements Act minimum prices for milk are to be fixed so as to approximate a "parity price," a figure representing farm purchasing power in the decade preceding the World War. Neither of these statutes has furnished much experience. Coal prices have not as yet been fixed; milk prices have been fixed only in a few markets, and protracted litigation has prevented continuous operation of the price orders. Moreover, both of these statutes deal with special problems. The Coal Act is frankly temporary, expiring by its express terms in 1941. Milk price fixing is primarily a local matter, applied to well-defined markets and to a commodity which has long been the subject of highly organized bargaining and complex local regulation.

Control of supply is exemplified by the Sugar Act and the Agricultural Adjustment Act. In both cases the standard of allocation is past performance. The Sugar Act again presents a special problem — the delicate adjustment of relationships among the sugar producers of the United States and those of Hawaii, the Philippines, Porto Rico, and Cuba. The Agricultural Adjustment program has gone through a good many vicissitudes — the benefit payment system, the soil conservation system, direct control of marketing quotas. No solid body of experience is yet available. In any event, the significant question is whether we can apply to industrial production a technique which may be suitable to agricultural commodities characterized by huge surpluses, perfect competition, and a price determined in world markets.

The administrative task of direct regulation can best be understood by considering a successful example — the regulation of the Stock Exchange by the Securities and Exchange Commission. The circumstances are unique. The subject of regulation is a single entity located in one place — the New York Stock Exchange (other exchanges may be put to one side as of minor importance). The members of the Exchange are limited in number and easily identifiable. They have long been accustomed to detailed and intricate regulation through their own governing body. The commodity dealt in has only one significant characteristic — price. That price is instantly determinable at any given moment through the most remarkable reporting system yet devised. The objective of the regulation can be stated in the simplest terms: freedom of the market from manipulation and abuse. There are no problems

of over- or underproduction, no labor problems, no satellite communities and industries. Moreover, the Commission has found ready to hand a reservoir of trained personnel, brokers, customers' men, analysts, and lawyers who have specialized in securities issues. With all these advantages, the Commission has found the task far from easy.

The administrative problem of the regulation of almost any productive industry is infinitely more complex. If price were to be regulated, the initial difficulty of determining the actual price structure would in many cases be insuperable. If production or investment were to be regulated, the problem of finding a standard which would not result in a freezing of productive capacity would tax the keenest imagination. Above all, there would be the problems of policing, of finding adequate personnel, and, indeed, of obtaining even the most elementary facts of business activity. The administrative machine would have to be so large that, expense aside, it would tend to break down under its own weight. Under these circumstances, it seems desirable to limit direct regulation to special situations in which no other way out can be found and to selected areas of other situations where it can be used as a significant complement to other methods of control.

CHECKING DOMINANT CONCERNS

Many of the evils of present-day industrial organization are ascribed to the growth of dominant concerns. Price leadership, rigid price structures, the exercise of irresponsible power over competitors and consumers are traceable, in numerous industries, to this factor. The problem first received serious governmental recognition in Section 7 of the Clayton Act, which prohibits the acquisition by one corporation of the stock of a competing corporation where the effect may be to substantially lessen competition. The story of the emasculation of Section 7 is too well known to bear repetition here. In the present state of the law it is altogether ineffective. A movement to strengthen Section 7 is now under way, and a great deal can be accomplished towards making it effective. Nevertheless, the limitations of any attempt to control mergers by a general prohibition are obvious. No one can say what the optimum size of an efficient enterprise is in any given industry. Manifestly, it varies greatly from industry to industry. A modern continuous rolling mill for steel involves an investment of ten or twelve million dollars; paper boxes can be efficiently

manufactured by a machine costing some hundreds of dollars set up in an abandoned barn. Efficiency in certain industries may depend not only on technological factors but on the market conditions, on the ability to secure a demand sufficiently extensive, continuous, and diversified to permit low-cost production.

The evils of the dominant concern and the problem of reconciling its existence with the requirements of mass production and integrated operations have been recognized for decades. Yet no serious attempt to determine optimum size for any given industry has been made. Until this is done, attempts to limit growth will fall far short of achieving maximum results. A more fruitful approach than that of the size of enterprise might be a consideration of limitations upon combination and integration of functions. Granted the advantages of vertical integration of productive processes, to what extent should a single concern be permitted to engage (a) in further finishing of its main product in competition with its own customers, (b) in extensive activity in industries related to its own, (c) in unrelated industries? Isolated examples of such limitations are to be found. Under the Commodities Clause of the Hepburn Act, the railroads may not carry the products of industries which they control. By the Packers' Consent Decree, the meat packers were prohibited from engaging in numerous activities other than meat-packing. Mention may also be made of the statutory divorce of commercial and investment banking.

These considerations apply with equal force to attempts to limit growth by tax devices. Unless we are prepared to say that no corporation may exceed a capitalization of x dollars, no statute of general applicability can be drawn. The possibility still remains of applying the tax device to specific industries, but it should be done only after serious consideration of the extent to which concerns should be permitted to grow and to spread to other lines of endeavor.

It would appear to be easier to prevent the growth of dominant concerns than to reduce them after they have grown, and yet the reverse is the case on the basis of experience. The Sherman Act has demonstrated its effectiveness in splitting up dominant concerns in some notable cases — the Lehigh Valley anthracite coal situation, the American Tobacco Company, the Standard Oil Company. It has been said again and again that these dissolutions accomplished little, that the new corporations found ways of reuniting again. This does not demonstrate the ineffectiveness of

dissolution so much as it does the necessity of constant surveillance after dissolution has been accomplished. The outstanding advantage of the Sherman Act technique here is the ability to deal with individual cases in accordance with the requisites of each situation. Whether the dissolution accomplishes the objective depends on the degree of economic understanding which the government prosecutors and the court are able to muster.

The Public Utility Holding Company Act has familiarized us with another method of splitting up dominant concerns — the administrative method. Here a happy combination of general rule and flexibility of application has been brought about. The standard required for holding companies is "geographic and economic integration." The Commission takes up each holding company in turn and attempts to work out a solution which will bring each public utility system within the general standard. Public utility power systems are bound together by physical stands — the wires. "Geographic integration," at least, is a term easily comprehended. In the case of industrial concerns the standard would have to be a great deal vaguer, so vague perhaps that the net result would be a Sherman Act with a commission substituted for the courts. Possibly that alone would be a sufficient reason for using the Holding Company Act method in the industrial field. But, again, that method would be unavailing without a sound basis for determining optimum size of concern, and the same consideration applies to the use of the Sherman Act for this purpose.

STRENGTHENING BARGAINING POWER OF WEAK INTERESTS

One method of governmental intervention involves so slight an application of governmental power that it is not often recognized as a method of industrial control. This is the deliberate strengthening of the bargaining power of weak interests through combination. The theoretical basis of this method is that the competitive system cannot operate unless the parties to a bargain have substantial equality. The classic examples are the laws permitting labor organization and the encouragement of agricultural coöperatives through the Capper-Volstead and allied acts. There are other examples, however. The Webb-Pomerene Act permitting combinations of exporters is essentially a device to strengthen American exporters as against foreign cartels.

This technique is capable of expansion and adaptation, but the desirability of such expansion is open to doubt. It is fre-

quently assumed that mass buyers will exercise heavy pressure on the price structure and thus force the passing on to consumers of the gains of technological progress. The automobile companies are as good an example as we could find of this. There are other instances, however, where mass buying has failed to bring about such a result. This is due either to the fact that, through reciprocal and other pressures, the producer is enabled to force the purchaser to take his product at the higher price, or to the fact that the buyer forces down the price but keeps the resulting savings for himself. In the latter case, it may be to the interest of the large buyer to bring about a high open price to be charged to his smaller competitors, while securing for himself lower prices through secret rebates and special concessions. There is some danger that cooperative action by a group of small buyers would have similar results. Witness the charges which have been made that agricultural coöperatives in some markets have made alliances with dealers to exclude non-member producers from the market.

In short, the strengthening of the bargaining power of weak interests has great advantages in furnishing checks on abuse of economic power which involve the very minimum of governmental activity. Its major weakness is its inflexibility in the face of changing conditions. Moreover, it creates new economic forces susceptible of abuse and necessitating some other mitigating or supervisory technique.

Allied to but quite different in effect from the strengthening of bargaining power through combination is the strengthening of the economic position of favored groups through special privileges granted by the government. No method of governmental intervention is more susceptible of abuse. Two large categories can be discerned: in the one a bounty is given to the favored group; in the other the favored group is granted a privilege which serves as a weapon against another group. The first category is exemplified by the protective tariff, the second by the state Fair Trade acts and the Miller-Tydings Act. Whatever unfortunate economic effects the grant of special privileges may have, we shall probably always have them with us in one form or another. The best way to avoid the more uneconomic forms of privilege is to provide desirable substitutes. The Fair Trade acts were conceived as the protection of the little man against the mass power of large concerns. The existence of the small independent firm constitutes a value which the American people will not lightly discard. Cer-

tainly this value can be aided in other ways than by placing uneconomic burdens on the efficiency of mass distribution. If special privileges are needed, resort can be had to credit devices, governmental loans, public buying aids, and the like. In the long run even an outright subsidy to small business may prove to be cheaper than a frozen retail price structure and enhanced distribution costs.

CARTELIZATION

The legally recognized cartel is a variant of the special-privilege method just described, but its importance requires separate classification. Since the collapse of the NRA it has fallen out of favor, but it has powerful supporters and it remains ready for reinstatement at any moment. We may safely assume that the fully self-governing cartel on the German model will never be accepted here unless there is a complete reversal in our economic and political ideals. The American cartel, if it comes, will look very much like the NRA code authority, an industrial association exercising police powers over its members, with some governmental participation and supervision.

This is not the place to debate the economic merits of cartelization, but some of the more obvious political considerations may be pointed out. An inherent difficulty in direct regulation is the danger that the industry under regulation will capture the regulatory agency. This danger is vastly greater in a governmentally sponsored cartel. Again and again it has been pointed out that a thoroughly cartelized industrial organization is an easy road to fascism. This fear cannot be dismissed as an imaginative exaggeration. It may be naïve to speak of cartelization as a cause of fascism; yet experience has shown it to be a ready instrument of those forces which seek to establish a fascist state. Governmental controls may be successful for a time in checking the power of cartels; in time of crisis they can easily be subverted. We are considering here techniques of governmental control of industry in a democratic state. Cartelization involves such danger to democratic processes that we may well exclude it as a possible technique.

Reference was made earlier to the subtle change in objective which the adoption of a particular method may entail. Cartelization presents an aggravated danger in this respect. Cartels are usually dominated by the larger concerns, intent on stability of price and production and on controlling competitive tactics of

aggressive newcomers. Protection of established investment and profit margins become the primary considerations of cartel managers. To choose the cartel as an instrument for securing an expanding economy is as logical as placing an atheist on the papal throne.

COMPENSATORY AND SUPERVISORY DEVICES

Much attention has been devoted to the use of compensatory devices, such as credit expansion and public works, to control the business cycle. We have had little or no consideration of the applicability of similar devices to other industrial problems. A few possibilities may be mentioned here. Government purchasing is a factor of major significance in many industries. An intelligently directed procurement policy might not only be used to level off minor cyclical fluctuations of production but might also exert a decided effect on industrial prices. Nor should we neglect the possibility of stimulating small business through this means. A noteworthy fact which has received little attention is the recrudescence of small shipyards, particularly on the Gulf and West coasts under the stimulus of the Maritime Commission program. A flexible tariff policy could be related to the control of monopoly prices, at least in those situations in which the tariff is effective in excluding foreign competition. Governmental privileges, patents, subsidies, tax exemptions, could be awarded on conditions which would insure better social use by the recipients. Such devices are, of course, of only limited applicability and would require expert guidance of a high order. An exploration of their possibilities is urgently needed.

In a number of situations the government has resorted to various devices designed primarily to bring the operations of concerns before the public and interested groups and to enforce a higher degree of public responsibility. Chief among these devices is the periodic report to a governmental agency or some other body. The reporting provisions of the Securities and Exchange Act, of the Webb-Pomerene Act, and of the Bituminous Coal Act (specifically with relation to the operation of licensed sales agencies for coal) are examples. It is a technique long familiar in judicial administration of business enterprise through trustees or receivers. Periodic reporting, it is true, often tends to become perfunctory. The sole remedy is an alert group of persons in the agency receiving the report, though it is not easy to remain alert in the face

of a constant flood of routine reports. Nevertheless, such reporting is an essential auxiliary of other types of control.

Other types of supervisory devices which suggest themselves are governmental regulation of the process of electing management (as in the control of proxies) and direct public representation on boards of directors. The former method is of relatively minor importance in view of the inability of stockholders to form any definite judgment about the abilities of management. The latter method could become of great importance if public representatives were designated who were seriously devoted to general economic and social interests. If they were to fall into the ordinary routine of most corporate directors nothing whatever would be changed.

GOVERNMENT COMPETITION AND PUBLIC OWNERSHIP

No more potent instrument for the reduction of monopoly price has yet been devised than government competition. The effect of the power program of the TVA on utility rates over a large area cannot be doubted. Freight rates are substantially lower because of the competition of the Panama Canal and the inland waterways system. The parcel post system has profoundly influenced the charges of the express companies. High as the costs of naval construction are they would unquestionably be higher if it were not for the competition of government navy yards. Public housing has already begun to affect the price of private housing. With this experience the question may well be asked whether government competition is not the solution to the problem of price.

The subject deserves far more extended discussion than is here possible. Reference can be made only to a single difficulty which is immediately apparent. It will be noted that each of the instances of government activity mentioned above had its own social and political appeal distinct from the question of price. The TVA and the inland waterways involve development of national resources; the Panama Canal and the navy yards, national defense; public housing, the relief of low-income groups; the parcel post system, a logical extension of the Post Office. Would any of these activities (excepting the parcel post system, backed by the pressure of the farmers and the mail-order houses) have been politically possible if they had been based solely on the appeal of lower prices? The history of the TVA is instructive. Despite the appeal of development of a neglected area, of flood control

and of national defense, despite its application to a monopolistic industry where governmental limitation on price and public regulation are accepted facts, political opposition has been implacable and successful at least to the extent of seriously impeding the program. Picture the political problem involved in initiating and administering government competition solely out of considerations of price control in industries which have never been subjected to regulation. The probabilities are that government competition, unless as an incident to some traditionally acceptable governmental activity, would be practically feasible only in industries clearly recognizable to the popular mind as monopolistic.

Where public ownership is used as a yardstick for private industry it can be considered a method of regulation. Where it displaces private enterprise it is no longer regulation and reaches into a realm beyond the scope of the subject here considered. There is, however, an intermediate stage of public ownership, a partial displacement of private enterprise in restricted industrial areas which needs mention here.

Most cases of public ownership in capitalist economy can be ascribed to either of two causes. An industry important to the national welfare collapses, and the government takes it over to prevent cessation of operations or to bail out the owners. The nationalization of the coal mines in Britain is a prime example. If our railroads should be taken over by the government it would probably be for that reason. The other chief cause of public ownership is the desire to furnish service below cost to low-income groups, these services being partially subsidized out of general tax revenues. Municipal water works and transportation systems were our outstanding examples until the recent ventures into public low-cost housing. This second type of public ownership might be used with advantage as an auxiliary to some type of regulation. Thus, it may be found that costs of distribution of a commodity are such that the price cannot be reduced sufficiently to reach the lower income levels by any available method of regulation. Public ownership of a portion of the distributive system should then be considered as a possible solution.

COÖRDINATED APPLICATION OF METHODS

It will be apparent from this brief survey that each of the methods described above has distinct limitations. Nearly all of them, however, are adaptable to one situation or another. It is

submitted that, instead of searching for a universal formula, attention should be directed towards the application of a combination of methods in given industrial situations. The milk problem may serve as an example. The Sherman Act technique can be used to insure free access to the market and freedom of competition for the various methods of distribution (house-to-house delivery, cash and carry store distribution, milk depots, etc.). The Capper-Volstead Act can be applied to strengthen the bargaining power of farmers as against distributors. The method of direct regulation, ready to hand in the Agricultural Marketing Agreements Act of 1937, can be applied to deal with the problem of the seasonal surplus. Public ownership of bottle exchanges may solve the problem of the domination of this essential common utility by the larger distributors. A coördinated application of all these methods holds forth greater hopes of success than a public-utility type of regulation of all incidents of the milk business. The administrative burden would be considerably less, and the consumer would probably be better off in the end.

Among all the fields now open for political and economic research, few offer better prospects for the student than this one. The detailed study of each of the methods of regulation here mentioned and of the possibilities of their coördinated application to specific industrial situations is urgently needed.

Transcending the problems of specific industrial situations is the problem of the national economy as a whole. A coördinated application of various control methods to a given situation must take into account the effect on the economy as a whole and the effect on related situations. This aspect of the problem has received little consideration in the past. The method which the government has adopted has, in most cases, been determined by the particular pressures exercised at the moment of adoption. A group desiring special protection or privilege cannot be expected to pause before a vaguely defined danger to the general economy. The duty of defining such dangers more sharply and of adapting proposed measures so as to ameliorate the dangers rests upon the experts, governmental and non-governmental alike. Even were the approaches here suggested to meet with a success far beyond our expectations, the over-all problem would still be with us. That problem also requires a coördinated application of techniques and policies dealing with banking, currency, taxation, industry, agriculture, production, distribution, and all the rest of our economic

questions. I pass no judgment on the possibility of an intelligent comprehension and direction of so many diverse and complicated situations. I feel more certain of the capacity of men to find rational and workable solutions for given industries considered case by case.

THE PRICING OF BITUMINOUS COAL: SOME INTERNATIONAL COMPARISONS

John P. Miller

FORCES INFLUENCING PRICE-MAKING IN THE BITUMINOUS COAL MARKET

THE bituminous coal industry is one of considerable interest to students of industrial markets and public policy. In all countries in which it is of quantitative importance, the industry has been the frequent object of controversy and of concern to public authorities. In the United States the problem has at times been that of rapidly rising prices, while intermittently the industry has been racked by serious labor disturbances and shocking conditions of work. Since the World War, the industry has experienced a long period of receding prices and wages. Although the process of adjustment has been long and arduous, intensified after 1929 by the general depression, the industry was left during this period to its own devices. Prices and output were subject to the play of market forces. Eventually, with the coming of the NRA, and later with the establishment of the National Bituminous Coal Commission, remedies were sought through schemes for price control.

Meanwhile, other countries had been experimenting with various schemes of organization and control. In Great Britain, where the structure of the industry is in many respects similar to that of the United States, there was a similar period of distress after the war. However, institutional factors, especially in the labor market, and controls of price and output fostered by the government were important conditioning factors. It is not surprising that the course of prices and wage rates there should have been substantially different from that experienced in the United States. Meanwhile, in Germany, the coal and lignite industries were organized under some eleven syndicates which undertook to control output and prices. These syndicates were fostered by the government but at the same time subjected to a degree of control in their policies.

Here, then, are three interesting experiments in public policy with respect to price-making. A comparison of the price policies in these markets and of their results should be instructive. Although the social scientist is unable to conduct controlled experiments, one alternative lies in comparisons such as are afforded by the bituminous industry in these three countries. This alternative, however, is not without its dangers. The differences in geological conditions, in market structure, and in the general political and economic milieu are innumerable, and the effects of these differences can in no way be eliminated. However, it is the purpose of this essay to outline the salient forces which impinge upon price-making in these three markets. Primary consideration will be given to the situation in the United States, the other two cases serving to illustrate alternative policies such as may be instructive in developing a more constructive public policy for this country.[1]

THE BITUMINOUS COAL MARKET IN THE UNITED STATES

The bituminous industry in the United States is highly concentrated in a few geographical areas principally east of the Mississippi River. Pennsylvania and West Virginia alone accounted for 52 per cent of the output in 1933. Ten states accounted for 91 per cent of the output.[2] This geographical concentration is a characteristic of major importance because of the impact of a depressed industry upon the economic life of the communities affected. The labor problems of a depressed industry which is widely scattered will be patently less pressing than those of one which is highly concentrated.

The number of producers in the industry is large. In 1935 there were some 6,315 commercial mines producing over 1,000 tons annually.[3] These mines were controlled by over 4,000 independent companies of which a few hundred represented "captive" companies, i.e., mines owned or controlled by a company which consumed all or the principal part of their output. Moreover, there is no large degree of concentration of control of output in the hands of a few. In 1929 the forty-eight largest producers

[1] The author is indebted to the A. W. Shaw Fund, administered by the Committee on Research in the Social Sciences of Harvard University, for financial assistance in gathering material for this paper.

[2] These states include Alabama, Illinois, Indiana, Kentucky, Maryland, Ohio, Pennsylvania, Tennessee, Virginia, and West Virginia.

[3] Bureau of Mines, *Minerals Yearbook*, 1937, p. 796.

controlled only 43 per cent of the output.[4] The largest producer controls only about 3 per cent; the four largest between 8 and 10 per cent.

In analyzing the pricing of bituminous coal, it is necessary to realize that we are not dealing with a homogeneous product. There are wide variations in the size and grade of coals. They vary substantially from mine to mine as to chemical and physical properties. Moreover, while coal is often sold as it comes from the mine, it is also frequently screened and sold in various sizes. The industry should be visualized as selling a series of products differentiated with respect to several variables. Some differences, such as size, heat value, moisture, sulphur, carbon, and volatile matter content, may be determined in general by scientific analysis. There are other variables, such as grindability, friability, and the coking, caking, and free-burning qualities which are not so easily determined except by individual experience with a particular coal in a particular burning equipment. In consequence, for short periods and over certain price ranges, there may be distinct consumer preferences for the product of particular firms.

The fact that there are these differences and that consumers cannot or will not readily substitute one coal for another, at least over short periods, means that there are a host of prices for bituminous coal for delivery at any one point. Moreover, the relations between the various prices are unstable because of variations in the conditions of demand and supply for particular coals. The fact that different grades and sizes are often produced as joint products in invariable proportions magnifies these variations in price relations. The instability of these relations, the "dumping" of odd sizes, and the sale of "distress" coal have been the cause of many charges of unfair competition in the industry. Sales of particular grades or sizes at low prices will not induce an instantaneous substitution by all buyers, although there are certain buyers who will purchase mainly on a price basis. Consequently, weakness in one part of the market may eventually have its repercussions on other parts. In this way, those who shift their patronage quickly upon small changes in relative prices act as a force holding in bounds the variations in price relations. The low prices paid by railroads for their coal are probably explained

[4] W. C. Trapnell and R. Ilsley, *The Bituminous Coal Industry, with a Survey of Competing Fuels* (Washington: Federal Emergency Relief Administration, 1935), p. 35.

as much by their ability to substitute one grade for another as by sharp buying practices of a predatory sort.

The buyers of coal from the mine operators are for the most part large-scale and well-informed. Bituminous coal is used principally in industry. The railroads consume about 25 per cent of the coal used annually within the country. Electrical utilities account for about 10 per cent of the consumption; coking plants use another 17 per cent; general manufacturing about 20 per cent. Domestic and a large number of miscellaneous users consume only about 28 per cent. It is reasonable to assume, therefore, that rational buying motives are dominant in the market.

The trend and character of the demand for bituminous coal during the last decade and a half is significant for an understanding of the recent condition of the industry. It appears that the demand for bituminous coal has been receding since its war-time peak, subject, of course, to irregular and cyclical swings. Previous to the war, the production of bituminous coal had been increasing rapidly. The war gave an additional impetus to the expansion of output and the opening of new mines. Because of several factors, such as strikes and car shortages, the opening of new mines continued until 1923. Despite a very substantial decline in the price of coal from 1923 to 1929, the quantity of coal sold never again reached the peak of 1918 and showed a tendency to decline from 1923 to 1928.[5] Conditions were not uniform, however, throughout the coal-producing areas. Illinois and Indiana experienced a very substantial decline in production both absolutely and relatively. Pennsylvania and Ohio likewise suffered severely. On the other hand, Kentucky, West Virginia, and parts of Virginia increased their production substantially. After making due allowance for such variations, it is nevertheless fair to conclude from the record of price and production during the 1920's that the industry was at the end of its expansion and facing a declining demand. This was due in part to the tremendous advances in the efficiency in using coal, in part to the development of fuel substitutes, and perhaps to a declining rate of expansion of our population.

Concerning the nature of the elasticity of demand for coal, little definite is known. A distinction should be made between the elasticities of demand for particular grades and sizes and the elasticity of demand for coal in general. We have noted above that in the

[5] The year 1926 was exceptional. Output increased substantially for the export market. This was the year of the General Strike in Great Britain.

short run, at least, there is only a limited tendency to substitute one grade or size for another even in the face of substantial changes in their relative prices. There seems to be a sufficient degree of substitution over time, however, to place limits on the dispersion of prices for different grades and sizes.

As for the demand for coal in general, it appears that it is highly inelastic in the short run. It depends principally upon the rate of activity of the industries using coal. There is little possibility of competition from substitute fuels, so that short-run changes in the relation of the prices of coal and its substitutes would not affect the elasticity of demand for coal significantly. Moreover, the fact that coal is largely a complementary agent used in production would suggest that the demand is probably less elastic than the demand for the goods produced. Further, the elasticity of demand for coal at the mine is much less than the elasticity at the point of consumption. This follows from the fact that the costs of distribution, which include costs of transportation and wholesale and retail margins, are on the average large in relation to the price of coal and are highly inflexible. Consequently, a large percentage decline in the price of coal at the mine will mean

TABLE 1

Mining Costs: Appalachian Region (Division I), November 1933

	Cost per ton	Percentage of total cost
Mine Labor	$0.93	59.0
Mine Supplies	0.22	13.9
Other Mine Expenses	0.03	1.8
Royalties, Dues, Compensation Insurance, and Depletion	0.15	9.5
Depreciation, Taxes, Insurance	0.11	7.0
Sales and Administration	0.14	8.8
Total	$1.58	100.0

Source: W. C. Trapnell and R. Ilsley, *The Bituminous Coal Industry*, p. 73. These data are based on reports of the National Recovery Administration.

only a relatively small percentage decline in the price of coal at the point of consumption. These factors are also significant over the longer period. However, over the longer period the problem of substitutes is of more significance in some uses. If there is a change in the relation of the price of bituminous coal and its substitutes, which change it is expected will persist for a period of time, it may well pay some industrial consumers to adapt their

fuel-consuming equipment to the use of other fuels. Once this is done the process will not easily be reversed. This points toward a greater elasticity of demand in the longer period. But how elastic? On this little is known.

The nature of the costs of mining is equally significant for an understanding of the problems of the industry. The overwhelming importance of labor costs is especially noticeable. As is indicated by Table 1, mine labor represents between 60 per cent and 65 per cent of the total cost of production and sale, exclusive of return on capital, but inclusive of depreciation, depletion, and royalties. As has been suggested above, however, the supply of labor to many firms in the short run is relatively inelastic. This means that, in the absence of a strong union or other resistances, a decline of demand which brings pressure on prices will probably have repercussions on wage rates. An appreciation of this interdependence of wages and prices is most important for an understanding of recent problems of the industry and contemporary policy in the United States. Mine supplies account for another 14 per cent of costs. Royalties, dues, compensation insurance, and depletion, all charges which are more or less fixed on a per ton basis, but which vary in the aggregate with output, account for 9 per cent. These three categories constitute the principal short-run or variable costs.[6] Overhead costs in the form of depreciation, taxes, insurance, sales and administrative expenses, but excluding return on investment, amount to 16 per cent. It is to be noted that all these costs, with the exception of depreciation and depletion where this is involved, necessitate current out-of-pocket expenditure.

The industry is one in which the adjustment of capacity to demand is accomplished with great difficulty and only after some considerable period of time. The coal resources of the country are extensive, and experience between 1915 and 1923 shows that profitable conditions in the industry will induce an opening of new mines and a reopening of closed mines. The full effects of the opening of new mines, however, are not felt immediately, since it generally takes at least three years to bring a new mine to its maximum rate of production.[7] Consequently, the full effects

[6] It is sometimes provided that a minimum flat sum shall be paid as a royalty. In such cases the flat sum is not to be considered a variable cost.

[7] National Bureau of Economic Research, *Report of the Committee on Prices in the Bituminous Coal Industry* (New York, 1938), p. 14.

of profitable conditions in the industry upon productive capacity of fixed factors may not be felt until several years after the conditions have changed. On the other hand, once capacity of either fixed factors or labor has become attached to the industry, it is not quickly withdrawn. The investment in equipment and development is large and for the most part unrecoverable. The closing of a mine is in itself costly, especially if it is to be preserved for subsequent working. Labor is not easily mobile, since many mining communities are isolated and are one-industry areas. In this connection, a recent study by the FERA is of interest. This study found that about 50 per cent of the coal miners employed in 1930 were employed in essentially one-industry counties.[8] This suggests that for considerable periods the supply of labor in the face of a receding demand, far from being perfectly elastic, may be quite inelastic.

Two important factors which have conditioned the pricing policies of the industry since 1923 are the existence of unutilized capacity of a seasonal and cyclical sort and excess capacity in the secular sense. The demand for coal has distinct seasonal and cyclical patterns. During the off-peak periods there is substantial unutilized capacity. Since storage of coal is expensive, the fluctuations in demand are not met appreciably by fluctuations in stocks. Moreover, it is customary when running mines to operate with a full crew and to adjust the output of the individual mine by adjusting the number of days worked per month or per week. However, unit variable costs apparently decline slightly as output per week increases until the point of full utilization. This latter point is fixed by the number of days operated per week and the number of hours per day. At this point the variable costs of further output rise rapidly. In the off-peak periods, therefore, there are strong incentives to choose one of two alternatives, to maintain output or to withdraw from the market. If the mines are to be preserved for subsequent operation, the latter involves costs which must be weighed against temporary losses of current operation. Consequently, in an industry with a large number of producers, operating under varying conditions and without any

[8] This study shows that in 1930 there were thirty-six industrial counties in which 60 per cent or more of the productive industrial workers were employed in coal mining. These workers comprised about 50 per cent of the total number of coal miners employed in 1930. An industrial county is taken to be one in which the number of productive industrial workers (including miners) exceeds the number of agricultural workers. (Trapnell and Ilsley, *op. cit.*, pp. 5–8.)

strong traditions against price-cutting, it is not surprising to find considerable pressure upon prices during slack periods. Much of the coal sold prior to 1933 was sold under annual contracts, an arrangement which tended to mitigate seasonal fluctuations. This, however, only intensified the price fluctuations in the spot market, since it had to absorb the impact of unexpected changes in market conditions alone.

Excess capacity in the secular sense is a different matter. This may refer to fixed factors in the form of plant and business organization alone, or it may refer to the labor force as well. Because of the inelastic nature of the labor supply in the bituminous coal industry, it seems necessary to consider both. Excess capacity, of course, has reference to capacity to supply units of product at a price or over a price range. To characterize a market as having excess capacity means, in the sense in which the term is used in this paper, that there is momentarily a greater willingness to supply product over a certain price range than there would be if time were allowed to make all equilibrium adjustments. There is excess capacity if the quantity of factors associated with the industry would have been less if the present prospects of future demand and costs had been foreseen; or if in view of the present prospects fixed factors and labor show a desire and intent to withdraw from the industry with the passage of time. These two conditions would be equivalent if the rate of profit necessary to attract factors were the same as that which would repel factors already attached. In any event, the existing supply curve of the industry over the relevant price range is to the right of the position in which it would be if sufficient time were allowed for adjustment to present expectations.[9]

It would be impossible to make a statistical estimate of excess capacity as so defined. Moreover, no significant capacity figures for the industry are available. The figures generally presented are those published by the Bureau of Mines.[10] These, however, merely represent the output which might be produced by the

[9] It should be noted that unutilized capacity and excess capacity are different. There may be excess capacity without unutilized capacity. This might occur at a time of a temporary peak demand which is not expected to persist. Or there may be unutilized capacity of a seasonal or cyclical sort, associated with undercapacity. Thus, although present demand does not absorb all existing capacity, the future prospects may make the industry a profitable direction for new investment.

[10] Cf. E. G. Nourse and associates, *America's Capacity to Produce* (Washington: Brookings Institution, 1934), Chapter II and Appendix B, for estimates of excess capacity based on these data.

mines actually in operation during a given year if, with their given labor force, they were operated the maximum number of days, now taken to be 265 days. An index of excess capacity calculated by subtracting actual output from capacity so calculated is merely an index of changes in the number of days operated. Such an index makes no allowance for the potential output at existing or other prices of mines now closed or undeveloped. Nor does it allow for the possibility of expanding output of operating mines by increasing the labor force employed therein. Moreover, it assumes that the increase in demand will be of such a sort that it can and will be met by increasing the number of working days of existing plant and labor forces.

When looking back over a period of time, it is relevant in determining whether the industry was characterized by excess capacity in the present sense to observe the trend in the number of mines in operation and the number of laborers employed. The experience of the United States in the post-war period is presented in Table 2.

TABLE 2

MINES IN OPERATION AND PERSONS EMPLOYED

Year	Number of mines in operation	Average number of persons employed
1923	9,331	705,000
1929	6,057	503,000
1932	5,427	406,000

These facts present prima facie evidence of the existence of excess capacity during the 1920's. There was a pronounced tendency to contract both the fixed and variable factors attached to the industry. Whether that process has been substantially finished, it is more difficult to say.

These were the important characteristics of the industry during the decade 1923–32: a large number of unorganized sellers, large-scale and rational buyers, a secularly declining demand, excess capacity of fixed factors and labor, a relatively inelastic labor supply, rigid freight charges and wholesale margins. The effects of such conditions were almost inevitable. The average mine realization declined annually from $2.68 in 1923 to $1.31 in 1932 (Chart I). The evidence on the financial condition of the industry is far from complete. However, the reports of the Bureau of Internal Revenue show severe distress. Even in 1929, the best year in the

decade, more than 60 per cent of the companies reporting showed no net income. The net deficit of the industry for this year was over eleven million dollars.[11] Of sixty-nine companies for which information was available in the financial manuals, sixteen were reorganized between 1929 and 1936.[12]

The effects of price competition on wages and the character of collective bargaining are equally significant. Price competition led to a pressure on wage rates. Those areas which were strongly unionized resisted this pressure, only to find that they were losing their relative shares of the output.[13] This induced a gradual breaking up of the system of collective bargaining and the discontinuance of collective agreements. In the period from 1923 to 1929 the average yearly number of laborers employed declined from 705,000 to 503,000. At the same time, the average hourly earnings of miners and loaders, who constitute about two-thirds of mine employees, decreased by approximately one-quarter. The declines were especially severe in Ohio, Kansas, West Virginia, Illinois, and Indiana. The depression led to further declines. The

TABLE 3

INDICES OF AVERAGE HOURLY EARNINGS

(1922: 100)

Year	Miners and loaders	Other employees
1922	100	100
1924	92	92
1926	89	88
1929	75	80
1931	66	79
1933	43	58

Sources: United States Bureau of Labor Statistics, *Bulletins* Nos. 354, 416, and 601. These figures represent earnings per hour at face of mine including lunch time, but not including time involved in travel inside the mine. Data are based on samples for the first few months of the year for the principal bituminous coal states.

severity of these declines is indicated by Table 3. The index of payrolls declined during the depression from 100 in 1929 to 35.6 in 1932.[14] Per capita income of wage employees actually employed

[11] Bureau of Internal Revenue, *Statistics of Income for 1929*, p. 288.

[12] Based on a study of bituminous coal companies for which there were financial reports in Poor's and Moody's manuals for the year 1936.

[13] F. E. Berquist and associates, *Economic Survey of the Bituminous Coal Industry under Free Competition and Code Regulation* (published by the Division of Review of the National Recovery Administration, Work Materials no. 69), pp. 64ff.

[14] United States Department of Commerce, *Survey of Current Business*, Supplement, 1936, p. 40.

declined in a similar period from 100 to 52.8.[15] In short, the impact of conditions in the industry bore severely upon labor in the form of decreasing employment, wage rates, and wage income. These conditions were in part due to excess capacity in the face of a declining demand. They were intensified, however, by the interregional price competition, which was based on interregional wage differentials. This interregional competition was an important factor in the shift of production from the union to the non-union fields, especially during the Jacksonville Wage Agreement from 1924 to 1927. In the process, the collective bargaining system of the industry was severely broken and the labor organization demoralized.[16]

The quest of the mine operators for individual and collective security for their investment was one element in subsequent attempts at the stabilization of the industry. There can be little doubt, however, that the plight of the mine worker, his low wage income and his partial or total unemployment, and the distress of stranded mining communities have been the principal forces behind these policies of control.

THE BITUMINOUS COAL MARKET IN GREAT BRITAIN[3]

The experience of the bituminous industry in Great Britain offers an interesting comparison with that in the United States. The basic structures of the two industries are in many ways similar; but the depression of the British industry has been more acute, and attempts to regulate the industry are of longer standing. Moreover, the greater significance of the export market in Britain is an important conditioning factor.

In Great Britain, as in the United States, the coal fields lie in several distinct regions, each of which faces different conditions with respect to production and marketing. Because of these differences, as well as for other reasons, uniformity of opinion as to desirable policy is difficult to attain. Yet because of the interpenetration of the markets which the various production areas serve, depression in one part of the industry tends to put pressure on the others when the industry is left to the play of market forces.

The industry is characterized by a large number of independent

[15] United States Department of Commerce, *National Income in the United States, 1925–35* (Washington, 1936), p. 88.

[16] Berquist and associates, *op. cit.*, p. 187.

and competing firms.[17] There were in 1934 some 2,123 individual mines at work which it is believed were operated by "considerably more" than a thousand separate firms.[18] While the numbers are large, there are great disparities in the size of individual firms. The twenty-five largest firms, it is estimated, controlled 33 per cent of the production in 1934.[19] Moreover, in particular areas, such as South Wales, Northumberland, and Durham, the degree of concentration is even greater, two or three firms accounting for 50 per cent or more of the output. Even so, the existence of a large fringe of small firms has made difficult the exercise of market control whether by leadership or agreement. The competitive forces have, recent regulatory measures aside, been strong.

As in the United States, the demand for coal has been declining. Never since the war has production reached the pre-war level of 1913. In that year production was 287 million tons. In 1929 production was only 258 million tons, while in 1937 it had declined to 241 million tons. The market for British coal differs in one important respect from the market for coal in the United States in that British coal is one of the principal exports.[20] The post-war period has seen a large decline in this export market because of high costs, the development of cheaper foreign sources, the growth of nationalism on the Continent, and the stoppage due to the General Strike of 1926. This decline of the export market has fallen with particular severity on certain areas, particularly South Wales, eastern Scotland, and Durham. But the decline in consumption has not been confined to the export market. Domestic use has also been low. Consumption of bituminous coal per capita of population has declined from 89 cwts. in 1913 to 78 cwts. in 1929, and to 66 cwts. in 1933.[21]

As in the United States, the demand for coal has been declining.
cost of production. However, the pressure of declining demand and excess capacity has not borne with the same weight upon the proceeds from the sale of coal and upon wage rates in Great Britain. This is due in large part to the greater strength of the

[17] There are, of course, local agreements and recent policy is fostering amalgamations and centralized selling schemes (*post*, p. 159).

[18] Political and Economic Planning, *Report on the British Coal Industry* (London, 1936), p. 42, hereafter cited as PEP.

[19] *Ibid.*

[20] J. P. Dickie, *The Coal Problem: A Survey, 1910–1936* (London: Methuen, 1936), Chapter XIX.

[21] PEP, p. 97.

trade unions in Britain and the procedure by which wages are determined. The miners are for the most part unionized. Wage rates are now negotiated between the unions and employers by districts, although during the period 1921–25 wages were negotiated on a national basis. The wage is made up of two parts, a basis wage and a percentage addition.[22] The basis wage has been fixed as the result of experience and varies from district to district, mine to mine, and job to job. These change infrequently, most of them dating from 1911.

The percentage addition is so calculated as to allow for differences in the cost of living and in the prosperity of the industry in various districts. It is uniform for all mines in a district. The calculation of this percentage is at present arrived at by agreement to share in fixed proportions the difference between proceeds from the sale of the coal and the costs other than wages.[23] This is in essence a profit-sharing plan. In most cases, this excess of proceeds over other costs is divided in a ratio of 85 per cent to wages and 15 per cent to capital.

In the absence of output or price control this scheme would not put a bottom to price-cutting, which reflects itself in wage reductions short of a level determined by the basis rate. However, the system has been supplemented by a system of minimum percentages ranging, in 1934, anywhere from 22 per cent to 100 per cent of the basis rate.[24] Wages equal to the basis rate plus the minimum percentage must be paid whether proceeds justify them or not. Any deficiency in proceeds may, in some districts, be carried forward and charged against proceeds at some later date when otherwise it would be necessary to pay more than the minimum percentage. Moreover, provision is made for further allowances to the lowest paid workers to insure the receipt of subsistence wages. The net effect of this elaborate machinery has been to put a bottom to wages. Since they are the principal item in marginal costs, this puts a limit to the decline in the marginal cost curve. In a competitive market this might be expected to limit the decline in price in the face of a decreasing demand with excess capacity.

The plight of the British coal industry since the war has led to several attempts to alleviate the distress and correct the evils.

[22] PEP, Chapter VI; Dickie, *op. cit.*, Chapter XII.

[23] Costs exclude capital charges.

[24] PEP, p. 172.

Labor legislation apart, the attack of public policy has been from three directions: first, provision for the control of output and prices, including central selling schemes; second, the facilitation or even forcing of amalgamation; finally, the nationalization of royalties. Our principal interest lies in the first of these approaches. However, a word concerning the others may be appropriate. They are both concerned primarily with the more efficient organization of the industry. Nationalization of royalties has been advocated for a long time. Its purposes involve, on the one hand, a redistribution of the burden of royalty charges in accordance with present conditions and, on the other, facilitation of more effective organization of the collieries in accord with the geological structure rather than surface ownership. Provision was finally made for nationalization of royalties by the Coal Act of 1938.[25] Amalgamation has played an important part in post-war discussions of the industry. It was hoped to decrease costs on the one hand and to strengthen the industry in its selling on the other. The Report of the Royal Commission on the Coal Industry in 1925 had recommended that the government encourage amalgamation even to the point of providing "for a compulsory transfer of interests under existing leases where desirable amalgamations are prevented by the dissent of some of the parties or their unreasonable claims." [26] Legislation was passed in 1926 and 1930 for the purpose of facilitating amalgamation with powers to compel dissenters to enter such schemes. In actual practice the compulsory powers granted by legislation have not been effective.[27] Voluntary schemes were numerous. Between 1926 and 1937, some seventy-nine schemes for voluntary amalgamation (reduced subsequently by further amalgamations to fifty-nine) were accomplished, affecting works employing about 301,000 workers.[28] There are strong resistances, however, to compulsory amalgamation which have led the government to proceed slowly.[29]

Price-making in the coal industry in Great Britain during the 1920's was left for the most part to the free play of market forces.

[25] 1 & 6 Geo. VI, c. 52.

[26] Royal Commission on the Coal Industry, *Report* (1925), I, 233.

[27] A. F. Lucas, *Industrial Reconstruction and the Control of Competition* (London: Longmans, Green, 1937), pp. 91ff.

[28] Secretary of Mines, *Annual Report*, 1937, p. 14.

[29] For an excellent discussion of the forces in the British coal trade militating against amalgamations, see A. M. Neuman, *Economic Organization of the British Coal Industry* (London: George Routledge and Sons, 1934), pp. 47ff.

In the face of a stable or even receding demand, prices declined substantially. This is indicated by the decline in the index of proceeds per ton (i.e., net realization for coal sold commercially after deducting expenses of selling and delivery) from 100 in 1924 to 70.5 in 1929 (Chart I). This decline in proceeds was accompanied by a smaller decline in the index of wage rates (average cash earnings per man shift) to 86.6. Such a decline in average proceeds and wage rates accompanied a decline in the index of production to 96.5.

By 1930 sufficient support had been won to pass a bill through Parliament providing for control of output and price in an effort to stem the deflationary effects of unutilized capacity.[30] This legislation provided for a highly decentralized system of control. The industry was organized into some seventeen districts operating under a Central Council. The Council was made responsible for determining the maximum production of coal by the industry as a whole for a given period of time and for allocating this among the various districts. The districts in turn, under provisions of "district schemes," were made responsible for allocating quotas among the various producers[31] and for setting minimum prices. In the early years the allocations made no distinction between production for the inland and export markets. After 1935, however, allocations to a district were divided into two parts, one for the supply of each of these markets.

The general intent of this policy has been so to control output as to promote stability of price. It seems probable that the procedure has led to some curtailment of output and has been as much responsible for stability of price as has direct price control itself.[32] If we grant the general assumption that the demand for coal is quite inelastic, at least in the short run, we may assume that only a slight restriction in production would be necessary to raise prices or to maintain prices in a receding market.

Direct price control has been a more serious problem. In view of the number of sizes, grades, and qualities of coal and the

[30] This legislation was originally intended to be effective for only two years, but has subsequently been extended from time to time. It was extended by the Coal Act of 1938 until December 1942. A discussion of this legislation will be found in the books by Dickie, Lucas, Neuman, and PEP, previously cited.

[31] Quotas are transferable.

[32] Secretary of Mines, *Annual Report*, 1932, p. 25: W. Prest, "The British Coal Mines Act of 1930, Another Interpretation," *Quarterly Journal of Economics*, L, 322–324. Prest points out that the fact that output has quite generally fallen short of allocations is no indication that output control has been ineffective or insignificant.

numerous points of production and delivery, the successful control of minimum prices presented difficulties. The establishment of prices was left to the initiative of the district boards. Until 1934 there was no way of coördinating the prices of the various districts where they sold in common or interdependent markets. Consequently, conflicts in the policies of different districts and interdistrict price competition were frequent. In 1934 the central scheme was revised to permit such coördination. The "Central Council may inquire into any complaint by any Executive Board [of a district] regarding any act or omission of any other Executive Board in relation to the determination and enforcement of minimum prices and may give such directions as it may think fit to remedy the matter, the directions so given being enforceable by penalties." [33] This decentralized procedure for price-setting, which places responsibility primarily in the hands of district boards, subject to review by the Central Council in case of complaint, is in striking contrast with procedure in the United States, where, under recent legislation, the National Bituminous Coal Commission is responsible for the coördination and final establishment of all prices.

More recently (August 1, 1936) central selling schemes were established in most areas for the more effective control of price and for reducing cost of selling.[34] Several districts have provided for a central selling agency through which all sales are made. Most districts provided for a looser control of sales by the central authority. The individual producer continues to sell his own coal, but does so under the control of the Sales Committee, which, by means of a permit system, establishes the minimum price for sales, the tonnage to be sold, the place of delivery, and other conditions of sale. It is interesting to note, by way of contrast with policy in the United States, that English experience has led to this reliance upon centralized selling and output control rather than upon elaborate price-fixing.

THE BITUMINOUS COAL MARKET IN GERMANY [35]

The market organization of the coal industry in Germany and public policy with respect thereto stand in striking contrast to the

[33] Secretary of Mines, *Annual Report*, 1934, p. 25.
[34] Secretary of Mines, *Annual Report*, 1936, p. 22.
[35] The author is indebted to Dr. H. Bruening and to Dr. H. Friedlander for illuminating several aspects of the German experience.

conditions in Great Britain and the United States. During the post-war period the coal and lignite industries were organized under some eleven syndicates. Our attention will be devoted to the Rheinisch-westfälisches Kohlensyndikat, which operates in the Ruhr region, the principal area producing *Steinkohlen* (hard coal as distinguished from lignite) in Germany. The Syndicate, founded in 1893, has had a long history during which its policies have undergone various changes. This story is told elsewhere.[36] Our concern will be principally with the practices of the syndicate and the relation between the Syndicate and the state during the period from 1919 to 1932.

Control of the Ruhr *Steinkohlen* industry is highly concentrated in a relatively few firms. In 1930 the number of members of the Syndicate, which included all *Steinkohlen* producers in the area, was fifty-six.[37] This included companies producing coal in whole or in part for self-consumption. Five of these firms controlled about 50 per cent of the output; ten accounted for 69 per cent.[38] This concentration is explicable on various grounds.[39] It seems probable that production economies and marketing advantages are in large part responsible. Control by a few was fostered also by the geographical concentration of the industry and by the similarity of conditions of both a market and a technical sort with which the various mines are faced. Finally, joint action has been fostered by the state in order that the Syndicate might function the more effectively. This concentration, which had gone far before the war, was greatly furthered during the rationalization movement which set in after 1924.[40]

The Rheinisch-westfälisches Kohlensyndikat is an association of all the producers of *Steinkohlen* in the Ruhr area. Membership in the Syndicate is now essentially compulsory. It is responsible for the control of output and the allocation of sales-shares on the

[36] A. H. Stockder, *German Trade Associations: The Coal Kartells* (New York: Henry Holt, 1924); *Regulating an Industry: The Rhenish-Westphalian Coal Syndicate, 1893–1929* (New York: Columbia University Press, 1932).

[37] H. Wagenführ, *Kartelle in Deutschland* (Nuremberg: Krische and Company, 1931), p. 31. This figure is given by several of the authorities. It apparently overstates the number of independent producers. In 1927 there were only thirty-eight independent quotas allocated by the cartel (*Kartell-Rundschau*, 1927, p. 133). It is improbable that the number has since changed substantially.

[38] R. A. Brady, *The Rationalization Movement in German Industry* (Berkeley: University of California Press, 1933), p. 73.

[39] H. Levy, *Industrial Germany* (Cambridge University Press, 1935), pp. 24–30.

[40] Brady, *op. cit.*, pp. 71ff.

one hand and functions as a selling syndicate on the other. For the control of output certain basic quotas are established for individual members. These in effect determine the relative shares in the total output at any time which the particular member shall supply. As market conditions change, the Syndicate adjusts total output by determining by what percentage output is to be restricted below the quota. Throughout its history the Syndicate has been plagued by the conflict between those firms which produce large quantities for self-consumption (factory or captive mines) and the pure mines. The problem has been met by dividing the sales-shares into three parts. The pure mines receive sales-shares which limit their deliveries for open-market sales, and also a quota for self-consumption around the mine (*Zechenverbrauch*). The captive mines receive a third quota which limits the self-consumption by industrial works under common ownership (*Hüttenzechenverbrauch*).

Price-making by the Syndicate is complicated.[41] All coal not self-consumed must be sold through the Syndicate. There are two sets of prices in addition to those at which sales are made to the buyers. There are, first, the "base" prices (*Richtpreise*). These are set by the Syndicate for each type, grade, and size of coal, and are based on the mining costs of the high-cost mines. They are hardly prices in the ordinary sense; they represent an objective. Averge sales prices are not expected to fall below these base prices. The second set of prices is the "accounting" prices (*Verrechungspreise*). These are internal prices at which transfers of coal from the mine to the Syndicate take place. Such prices are set for individual mines and represent a modification of the base prices in order to make allowances for the different cost levels of the various mines. It is at these prices that the members of the Syndicate are paid for the coal delivered and sold through the Syndicate. Finally, there are the "sales" prices (*Verkaufspreise*) — that is, the prices at which the coal is sold to the buyer or consumer.

The sales policy of the Syndicate has long been based on a distinction between the noncompetitive or uncontested areas and the contested areas. When the German coal industry entered into

[41] For details concerning the control of output and price by the Syndicate, see the following: International Labor Office, *Report to the Technical Tripartite Meeting on the Coal Mining Industry; Part I, Economic Conditions*, pp. 235–239; Stockder, *Regulating an Industry*, *passim*.

a period of receding prices after 1873, one of the problems facing the industry was the increasing competition of English coal, especially in the North Sea and Baltic areas.[42] Consequently, the industry has been impressed from an early period with the distinction between the domestic and export or competitive markets. Early attempts at cartel control of the industry experimented with various techniques for segregating markets and for expanding sales in the competitive markets while maintaining prices in the protected areas.[43] Such discriminatory pricing policies were pursued for the purpose of improving the financial condition of the industry. The alternative appeared to be contraction of the industry, since costs apparently did not justify maintenance of existing capacity at uniform prices such as were necessary to retain the contested markets. The Ruhr producers located in a highly concentrated producing area had a large natural market in which they were protected against competition from abroad or from other producing areas in Germany. The Syndicate agreement of 1925, which marks the climax of the technique of separated markets as practiced by the Ruhr producers, divided the market into two parts: the contested area, consisting of Holland, other foreign countries, the port of Hamburg, and the territory east of the Elbe River; and the uncontested market, consisting of the area contiguous to the Ruhr, protected by natural factors and transportation charges, and the competitive markets of Berlin and Magdeburg. This distinction between contested and uncontested areas is still at the core of the Syndicate's selling policies.

The sales price (*Verkaufspreise*) of the Syndicate apply only to sales made in the uncontested areas. They are never below the base price, though they may be more or less than the accounting prices. Moreover, these minimum prices apply only to sales to large-scale consumers in the uncontested area. Recognized wholesalers receive a rebate of 6 per cent below these minimum prices for all deliveries in the noncompetitive territories.

Sales in the contested markets are made at prices set from time to time by the Syndicate. Not much is known about the considerations which determine the competitive policies of the Syndicate in these markets. For the purpose of financing the sales in contested areas at prices lower than in the uncontested areas, a tax (*Umlage*) is assessed on all sales in the former territories. The

[42] Stockder, *German Trade Associations*, p. 44.
[43] *Ibid.*, pp. 44, 56.

proceeds of this tax are used to make up the deficiencies between the price received for sales in contested areas and the accounting price at which it is determined that coal should pass to the Syndicate. The effect of this is to make the rewards to the producers the same whether their output is sold in the contested or uncontested markets. The size of the tax is varied from time to time in such a way that the average selling price of all coal sold shall be at least equivalent to the base prices.[44] The effect of this procedure has been such as to give relative stability to proceeds per ton f.o.b. the mine and to prices in the noncompetitive areas, while at the same time permitting the necessary flexibility to enable the Syndicate to meet competitive conditions in other markets.

Throughout the life of the Syndicate there has been a continual struggle over the channels through which sales to ultimate consumers should be made. Various members of the Syndicate have developed their own wholesale affiliates, in part as a protection against the time when the Syndicate might dissolve. These members have often found themselves in conflict with the Syndicate on the one hand and the independent distributors on the other. The right to supply some large consumers has in general been reserved to the Syndicate. For the rest, sales are made principally through the Syndicate wholesale companies and the distributive affiliates of the mines.[45] This conflict of interest between mines having their own distributive channels and those not so situated, together with the conflict between the owners of pure and captive mines, has been the cause of many difficulties faced by the Syndicate in achieving voluntary renewal of the agreement from time to time.

The government has exercised a restraining influence upon the policies of the Syndicate through its dual position as an important producer of coal and as a regulator of the coal industry under the Coal Law of 1919. The Prussian government had originally operated mines in the Ruhr region for the purpose of supplying the needs of the state railroads.[46] In 1903 the Prussian government began to expand its operations, and by 1911 it became the chief competitor of the Syndicate. In the latter year the govern-

[44] The tax varies in amount between the sales-shares for deliveries in the open market and the quota outputs for self-consumption by factory or captive mines. Part of the output quota for self-consumption is exempt from the tax.

[45] Brady, *op. cit.*, p. 96.

[46] Stockder, *Trade Associations*, p. 85, n. 40.

ment entered the Syndicate. It subsequently withdrew for a time because of its objections to the policies of the Syndicate. During the war and post-war periods the position of Prussia as a member of the Syndicate has given the government considerable leverage in affecting the policies and success of the Syndicate. On the one hand, the government has fostered the Syndicate because it believed this form of organization to be desirable for the promotion of stability.[47] On the other, the state as a producer, by threatening to compete outside of the Syndicate, has been able to exercise some check upon its policies. With all the knowledge and experience acquired as an incident to its production activities, the state is in a position to participate in the affairs of the industry and to throw its influence in whatever direction it deems desirable.

The second basis for control by the government over the policies of the Syndicate was provided by the Coal Law of 1919.[48] This provided for the organization of the German coal industry into eleven syndicates patterned for the most part after the Rheinisch-westfälisches Kohlensyndikat. Labor had representatives on the various administrative boards of the syndicates. A union of the syndicates was established, the Reichskohlenverband, membership in which included the eleven coal syndicates, the gas-coke syndicate, and those states of the German Federation which owned and operated coal mines. Labor and consumers had representatives on its board of supervisors. This body was made largely responsible for administering the regulations concerning the production and marketing of coal. It was to fix maximum prices to be charged by the syndicates but in doing so was to consider the recommendations of the syndicates and the interest of the public. Above the syndicates and the union was the Reichskohlenrat, a council of some sixty members representing employers, employees, the German states, dealers, and consumers. The function of this body was to direct "the fuel industry, inclusive of imports and exports, for the general welfare." It was responsible for approving the basic agreements of the syndicates and for general regulations to suppress undesirable competition and protect the consumer. The Reich government reserved to itself, through the agency of the Reichswirtschaftsminister, the power to suspend any action taken by the Reichskohlenverband, the Reichskohlenrat, or the syndicates, pending a hearing at which the Minister himself had

[47] R. Liefmann, *Cartels, Concerns and Trusts* (London: Methuen, 1932), p. 216.
[48] Wagenführ, *op. cit.*, pp. 24ff.

final jurisdiction. This elaborate structure was erected in the interest of order in the industry and protection of the general welfare. One student of the operations of German cartels has questioned whether the Reichskohlenverband and Reichskohlenrat have measured up to the declared policy of the act creating them.[49] Actually they act in their own interests, not in the interest of the *Gemeinwirtschaft*. The labor representatives, who with the producers are in general opposed to price cuts, have not changed this. Of course, the price policy of the Syndicate has not been free, but such control as there has been has been exercised by the Reichswirtschafstminister.

It is significant to note that this elaborate organization separates the responsibility for establishing minimum prices from the setting of maximum prices. The Minister, union, and council are concerned above all with the fixing of maximum prices. The syndicates, however, have power to set prices below these maximums. They are responsible through their central selling organizations for fixing minimum levels below which prices and proceeds shall not go. There is a separation of powers here which is in striking contrast to the system of control provided by recent legislation for bituminous coal in the United States.

SOME COMPARISONS

In the preceding sections the principal forces which impinge upon the pricing of coal in three different market structures have been sketched. In part the differences in market structure are conditioned by underlying economic forces. Thus in Germany the fewness of sellers and the cohesiveness of the Syndicate have been fostered by the geographical concentration of the producers in the Ruhr and the protected nature of a large part of its market, while in Great Britain and the United States the producing areas are more widely scattered and in a significant degree the markets of the various areas are interdependent. In part, differences are of an institutional sort or the result of conscious policy. Thus during the 1920's unionization was much less secure in the United States than in the other two countries. In consequence, wage rates, the principal element in costs, were subject to pressure through the competition of nonunion fields. Wage rates in the United States showed a steady downward trend from 1924 to 1933. In Britain

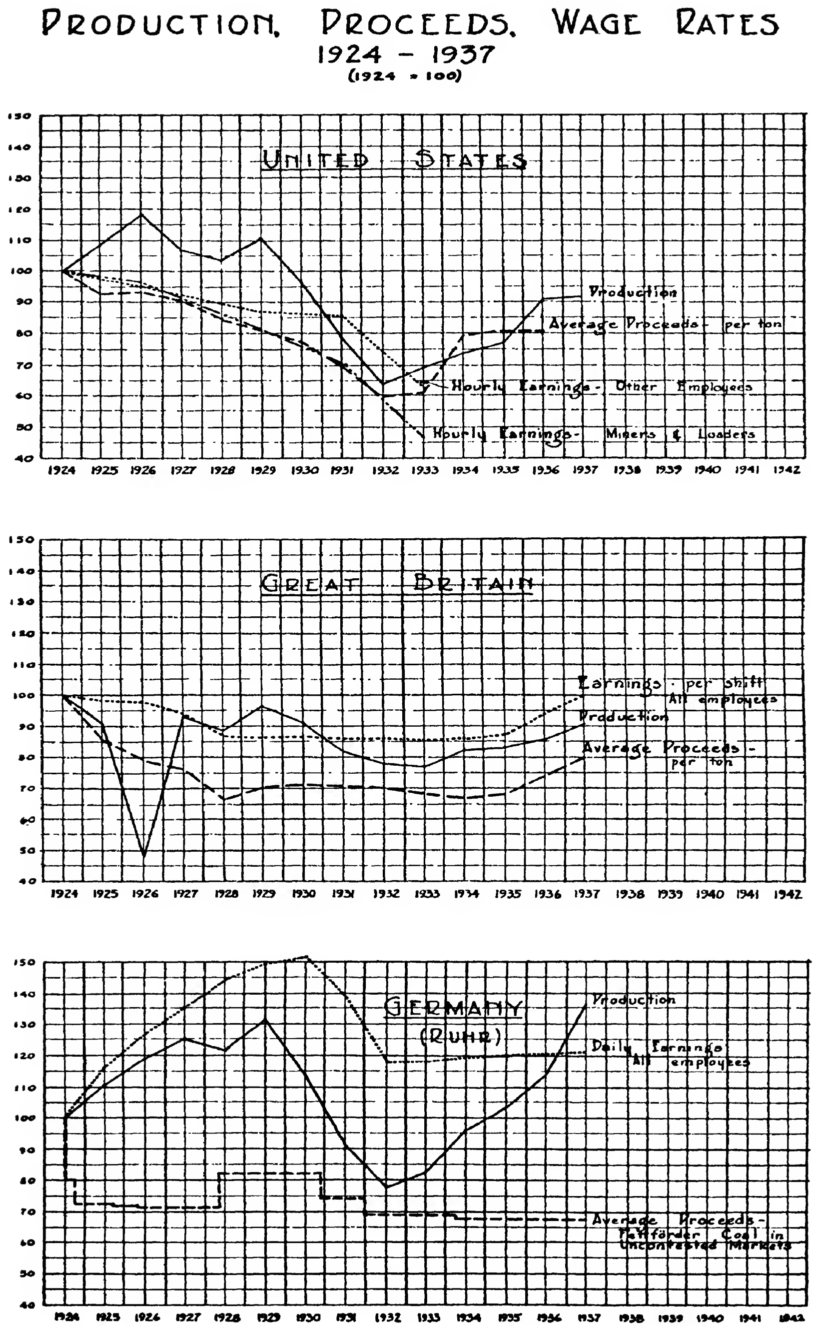
[49] R. Passow, *Kartelle* (Jena: Gustav Fischer, 1930), p. 157.

and Germany, however, collective bargaining has played a more important part in determining the level of wage rates. Wage rates in Britain have been characterized by a high degree of stability, especially from 1928 to 1935. In Germany wage rates rose markedly after 1924, coincident with the extensive reorganization of the industry, and reached a peak in 1930. Until 1929 this was a period of rapidly increasing output and declining costs.

Public policy has likewise played an important part in the differences in the forces impinging upon price in these markets. In Britain and Germany the government has facilitated or even enforced coöperative action intended to control price, while in the United States no such encouragement was given prior to 1933. German prices for delivery in the uncontested areas showed a high degree of stability. This is shown by the price index for Fettförder coal (Chart I). After the decline in 1924 the range over which this price varied was narrow. The lowest index was 68, the highest 82. Moreover, from July 1924 to April 1938 the price of this grade of coal in the uncontested area was changed only eight times. It will be noted, furthermore, that price changes in the uncontested areas in Germany were not closely associated with wage rates. In Britain proceeds from the sale of coal have since 1928 displayed a marked degree of stability, and trends in proceeds have been correlated quite generally with trends in wage rates. In the United States there has likewise been a marked correlation between trends in proceeds and wage rates. However, both fell quite drastically from 1924 to 1933, with no interruption during the prosperity of the late 1920's.

It will prove of interest to note the experience of the three countries during the period of recession, 1929–32. The comparative picture is well presented in Table 4. In Great Britain the indices of proceeds and of wage rates each declined by only one point. This was in the face of a decline in the index of production during these three years to 81. In the United States the index of proceeds declined to 74; the index of wage rates of miners and loaders, who constitute about two-thirds of the employees, declined to 58 and that of "other" employees to 73. These declines accompanied a drop in the index of production to 58. Thus in the United States wage rates declined proportionally more than proceeds, and both experienced severe declines. In Britain the declines in proceeds per ton and wage rates were small and roughly proportional. The difference in the changes of total money wage income was even

CHART I



PRODUCTION, PROCEEDS, WAGE RATES
1924 - 1937
(1924 = 100)
UNITED STATES
Production
Average Proceeds - per ton
Hourly Earnings - Other Employees
Hourly Earnings - Miners & Loaders
GREAT BRITAIN
Earnings per shift All employees
Production
Average Proceeds - per ton
GERMANY (RUHR)
Production
Daily Earnings All employees
Average Proceeds - Fettförder Coal in Uncontested Markets
150
140
130
120
110
100
90
80
70
60
50
40
1924 1925 1926 1927 1928 1929 1930 1931 1932 1933 1934 1935 1936 1937 1938 1939 1940 1941 1942

TABLE 4

COAL INDICES FOR 1932: INTERNATIONAL COMPARISONS
(1929: 100)

	Great Britain	Germany	United States
Production	81	59	58
Average no. of persons employed	86	54	81
Man-shifts worked	80	46	54
Output per man-shift	101	128	108
Average proceeds per ton	99	84[a]	74
Money wage rates	99	78[b]–80[c]	58[d]–73[e]
Total money wage income	79	37	36
Total real wage income	90	47	45

[a] See note on sources. [b] Employees below ground. [c] All employees.
[d] Miners and loaders. [e] Others.

Sources: *England:* Basic material taken from the *Annual Reports* of the Secretary of Mines. Data include a small amount of anthracite. Production is the total quantity of saleable coal raised. Proceeds are the realization from sale of commercially disposable coal, after deducting selling and delivery expense. Wage rates are based on average cash earnings per man-shift worked. Money wage income was calculated from data on number of wage shifts worked and average cash earnings per wage shift worked. This was reduced to real income by use of the cost of living index of the Ministry of Labour.

Germany: Basic material taken from the yearly *Statistische Übersicht über die Kohlenwirtschaft*, published by the Reichskohlenrat. Data applies only to *Steinkohlen* in the Ruhr. The index of proceeds is the index of the price of Fettförder coal for the uncontested markets. Wage rates are cash earnings per shift. Wage income was calculated from data on the number of man-shifts worked and cash earnings per shift. This was reduced to real income by use of the cost of living index given by the *Statistisches Jahrbuch für das Deutsche Reich*, 1937, p. 310.

United States: Basic material taken from *Minerals Yearbook* published by the Bureau of Mines. Man-shifts calculated from average number of men employed and average number of days worked. For source of the indices of wage rates, *cf. supra*, p. 153, Table 3. Index of total wage income is based on the index of payrolls of the Bureau of Labor Statistics and was reduced to real income by use of the cost of living index of the Bureau.

more striking. The index for Britain declined to 79, while that for the United States fell to 36. Total real wage incomes declined to 90 and 45 respectively. In Britain, where the wage rates and prices were highly stable, total output declined least, output per man-shift increased least, and both money wage income and real wage income suffered proportionately less.

The comparison with Germany differs in significant respects. The Syndicate in the Ruhr experienced a decline in output approximately proportional to that in the United States. The index of Fettförder coal for the uncontested areas declined only to 84

as compared to a decline to 74 in the average proceeds from the sale of bituminous coal in the United States. Wage rates in the Ruhr industry likewise experienced a less severe decline: the index for all employees declined to only 80 as compared to a decline to 58 for miners and loaders and to 73 for "others" in the United States. Total money wage income, however, declined in about the same proportion in the two cases, to 37 in the Ruhr and to 36 in the United States. A comparison of real wage income likewise shows roughly proportional declines. These differences between comparative declines in wage rates and wage incomes are to be explained by differences in the change in output per man-shift, productivity having increased much more rapidly in Germany. Thus, while wage rates declined proportionally less in Germany, the increase in physical productivity intensified the decline in employment. In consequence, while those employed fared relatively better in Germany, the depression was accompanied by a more substantial decline in the average number of persons employed. In the Ruhr, then, it appears that a policy of substantially increasing productivity was followed, but prices and wage rates were protected against declines of a magnitude such as was experienced in the United States. In England, as we have seen, no such improvement in physical productivity was experienced. It is probable that the particular policy of sharing output pursued in Britain was in part responsible for this.

RECENT POLICY IN THE UNITED STATES

It was inevitable that the experience of the industry in the United States after 1923 should lead to various proposals for the alleviation of the pressures of excess capacity. Attempts at self-regulation were discussed in the late 1920's.[50] As a result of these discussions, the Appalachian Coals Corporation was established as an exclusive selling agency for some 137 producers in the Southern High Volatile field. Plans were under way for similar agencies in other fields. However, the government brought suit under the Sherman Act, and, pending a decision, operations of the proposed agencies were suspended. By the time the Supreme Court found favorably for the Appalachian Coals,[51] the NRA was upon us. The experience under the code provided the immediate

[50] *Carter v. Carter Coal Co.: Brief for the Government* (298 U. S. 238, 1936), p. 64.

[51] *Appalachian Coals, Inc., v. U. S.*, 288 U. S. 344 (1933).

background for subsequent legislation.[52] The code provided for collective bargaining, for minimum wages, and maximum hours. Although the problem of interregional wage differentials was never settled, these differentials were narrowed. The code also provided for minimum pricing by various divisions and subdivisions of the industry. Inevitably the problem of interdivisional coördination of prices arose, and various experiments were made. Even before the demise of the NRA, however, problems of compliance were developing, rumors of price-cutting were rife, and special legislation for the stabilization of the bituminous coal industry was proposed.

The first fruit of these proposals was the Guffey-Snyder Bill of 1935.[53] Although the bill as originally introduced provided for production control, retirement of mines, and the rehabilitation of miners, as well as for price-fixing and the regulation of labor relations, as finally passed the act was confined to the regulation of prices and labor relations. The act was soon declared unconstitutional, largely on the basis of the provisions for the regulation of labor conditions.[54] Congress then proceeded to pass the Guffey-Vinson Bill of 1937, providing for price-fixing.[55]

The provisions of this most recent legislation are very elaborate. There is established in the Department of the Interior a National Bituminous Coal Commission of seven members, two of whom must have had previous experience as miners and two as producers.[56] There is written into the act an elaborate Bituminous Coal Code which deals with the control of the sale of coal. A tax is imposed on all coal sold equal to 19½ per cent of its sale price, but the producer is exempted from this tax if he accepts membership in the code. This tax, then, is simply a penalty tax intended to induce producers to abide by the pricing and marketing provisions of the code. The code specifies an elaborate procedure and extensive criteria for the fixing of minimum prices, and lists some thirteen unfair methods of competition concerned mostly with the terms and conditions of sale. The Commission is empowered,

[52] For a discussion of the code experience, see Berquist and associates, *op. cit.*

[53] National Coal Conservation Act of 1935: Public no. 402, 74th Congress (August 1935).

[54] *Carter v. Carter Coal Co.*, 298 U. S. 238 (1936).

[55] Bituminous Coal Act of 1937: Public no. 48, 75th Congress (April 1937).

[56] The Commission was abolished by the President's Reorganization Plan II, effective July 1, 1939 (Public Resolution 20, 76th Congress), and its functions transferred to the Secretary of the Interior.

if it deems it necessary, to set maximum prices, which must yield "a fair return on the fair value of the property." The act also provides that marketing agencies such as the former Appalachian Coals may be established and, if certified by the Commission, shall be exempt from the antitrust laws. Finally, there is established in the Department of the Interior the office of the Consumers' Counsel, who is to appear before the Commission to represent the interest of the consuming public.

The act relies principally upon price-fixing for its effectiveness. For the fixing of minimum prices an elaborate institutional structure and procedure are specified. The principal administrative units are the twenty-three districts into which the industry is divided. Each district operates under a district board. Prices are proposed in the first instance by the individual districts, but for purposes of determining the general level of prices another unit is established, the Minimum-Price-Area. There are ten of these areas, each consisting of from one to nine districts. The purpose of the Minimum-Price-Area will appear in the succeeding exposition of the procedure for the fixing of minimum prices.

The initial step is taken by the Statistical Bureau of the district, which is instructed to submit to the District Board cost data for the year 1936. The District Board then determines the weighted average of the total costs of the ascertainable tonnage for the district for that year. These costs do not include any capital charges.[57] With the exception of allowances for depreciation and depletion, all costs included involve direct out-of-pocket expenditure. The District Board is then instructed to adjust this weighted average cost to give effect to any changes since 1936 in wage rates, hours of employment, or other factors substantially affecting costs, exclusive of seasonal changes. The Board then forwards these cost data, together with supporting computations, to the Commission. The latter is thereafter instructed to determine the adjusted weighted average of the total costs for each Minimum-Price-Area, which is then transmitted to each of the district boards of the Minimum-Price-Areas.

At this point, specific minimum prices for each kind, quality,

[57] "The computation of total costs shall include the cost of labor, supplies, power, taxes, insurance, workmen's compensation, royalties, depreciation and depletion (as determined by the Bureau of Internal Revenue in the computation of the Federal income tax) and all other direct expenses of production, coal operators' association dues, district board assessments for Board operating expenses only levied under the code, and reasonable costs of selling and the cost of administration."

and size of coal are proposed for the first time. Each District Board proposes minimum price schedules which are to yield as nearly as possible a return per net ton *for the district* equal to the adjusted weighted average of total costs for the *Minimum-Price-Area* of which the district is a part. The Commission may then either approve, disapprove, or modify the proposed minimum price schedules. If they are approved, the District Board has to undertake the problem of coördinating its proposed prices with those of other districts selling into common consuming areas. In such coördination, the average return per net ton for the district must not diverge any more than is necessary from the established base, namely the weighted average cost for the Minimum-Price-Area. Upon approval of the prices, the Commission then establishes them as the minimum prices for the particular district. If any district fails to act to establish coördinated prices, the Commission may act in its place.

While this procedure may appear complicated, the criteria specified in the act for the setting of the many thousands of individual prices are even more so. As has been noted above, the *general level of prices* for any district is to yield as nearly as possible, subject to the requirements of coördination in common consuming areas, a return per net ton (f.o.b. mine) for the district equal to the weighted average of the total costs per net ton of the tonnage of the Minimum-Price-Area of which the district is a part.

The specific prices to be proposed by the district boards for each kind, quality, and size of coal are to "reflect, as nearly as possible, the relative market value of the various kinds . . . ," are to "be just and equitable as between producers within the district," are to "have due regard to the interests of the consuming public," and must not permit dumping.

The coördination of prices in common consuming areas is to be done "on a fair competitive basis." Coördination is to take into account such factors as the various kinds, qualities, and sizes; relative market values at the points of delivery; values as to uses; transportation charges; transportation methods and charges, and their effect upon a reasonable opportunity to compete on a fair basis; seasonal demand; and the competitive relations between coal and other forms of fuel and energy. These coördinated prices must be "just and equitable, and not unduly prejudicial or preferential, as between and among districts." They "shall preserve as nearly as may be existing fair competitive opportunities."

These are the elaborate criteria by which the Commission is to be guided. Behind each of these provisions there lies the story of some person, or some group, who feared for his security. Is it to be wondered that in trying to set some 400,000 individual prices, each of which is to satisfy these vague criteria, the Commission has met with difficulties? It is now over two years since the passage of the act, and the Commission has not yet completed the task of issuing effective prices. Price lists for some districts issued in the fall of 1937 were subsequently withdrawn, since it appeared that the courts would hold that the procedure followed in establishing the lists did not satisfy the requirements of the act.[58]

The questions raised by this legislation are manifold. The object, however, is clear — to alleviate low incomes, especially wage incomes, by protecting prices and wage rates. It would be questioned by some whether such procedures for protecting incomes are desirable. Some might argue that such policies will introduce more elements of cyclical price and wage stability of an undesirable sort. It might also be questioned whether raising prices and wage rates will not defeat their purpose by inducing resort to substitute fuels and to the introduction of labor-saving devices.

Even though one admits the general thesis, however, that an increase in wage incomes in this industry is desirable and that increased prices and wage rates are a means thereto, serious questions still remain concerning the desirability of the particular method used. Above all, one may ask whether it is administratively feasible to establish some 400,000 prices satisfying the specified criteria and whether, if established, they could be enforced. Under the present scheme the burden for establishing and policing minimum prices is placed on the government. This stands in contrast to policy in Germany and Great Britain, where industry itself assumes the burden of responsibility for minimum prices. If there is sufficient interest on the part of the industry in such a program, it should be feasible to put the burden of responsibility upon the industry. If there is not sufficient interest, it is very questionable whether such a program can be enforced.

The question also rises as to whether price-fixing, which takes the form of price-raising, can be effective without the further control of output and of the opening of new mines. So far as increases in price are matched by a rise in labor or other costs there may be no difficulty. The incentive to increase production

[58] Order no. 230, February 1938. Reprinted in *Federal Register*, III, 469.

and to open new mines depends not on price but rather upon the margin between price and costs. But what if the margin increases? May there not be a greater willingness to sell than to buy at the prices established?

Another problem is concerned with the inflexibility of the relations between the prices of various kinds, qualities, and sizes of coal. Is it not likely that the cumbersome process of price-fixing may tend to rigidify these relations so that they become unresponsive to changes in the conditions of costs and demand? This is a problem which need not arise if reliance were placed primarily upon output control and central-selling schemes.

A further question arises concerning the direction which competitive forces are likely to take. It appears that once minimum prices are established little role will be left for price competition between producers. Is it likely that competition will be diverted to advertising, selling pressure, and the rendering of various services to consumers free of charge? If so, is it possible that this will react to the benefit of the large and well-financed producers? Again output control and central-selling schemes would probably avoid these possibilities.

Finally, is it likely that price policy in conjunction with the wage policy of the unions will be used to obstruct shifts in the location of production which might be justified because of changes in market demand? The proviso that prices shall "preserve as nearly as may be existing fair competitive opportunities" suggests as much. Labor [59] and industry alike seem committed to a program which will not, at least for the present, dislocate tonnage. Will they resist adaptation to long-run shifts in markets?

As has been noted above, in Great Britain and Germany responsibility for controlling minimum prices has been placed upon the industry. In the latter country such protection of prices and wage rates as has been achieved has resulted from central selling and the control of output. In England output control seems to have been more significant in stabilizing average proceeds than direct price control has. More recently the British have turned to central-selling schemes. The success of these two countries in cushioning the effects of the depression was indicated in the preceding section.

[59] Senate Committee on Interstate Commerce, *Hearings on S. 1417, 74th Congress, 1st Sess.: Stabilization of the Bituminous Coal Mining Industry* (1935), p. 151. Testimony of P. Murray, representing the United Mine Workers of America.

Centralized selling schemes and the control of output would seem to be much easier to administer and police than an elaborate price-fixing formula. Moreover, it is probable that they would not have the same tendency to lead to a rigidity of *price relations*. Nor are such policies so likely to divert competitive energies into such questionable channels as advertising and high pressure salesmanship.

Output control may, of course, tend to obstruct rationalization and shifts in the location of production. It may protect inefficient areas and inefficient firms. In part this may be the purpose of the legislation. However, it need not be so administered. Allowances when allocating quotas might be made for trends in efficiencies and for changes in the market. If quotas were made transferable, there would be pecuniary incentives for concentrating production in the most efficient mines. Finally, it may be noted that the alternative of elaborate price and wage control may be little more than an indirect way of allocating production and as such may have equally untoward effects on efficiency.

Control of output and central-selling schemes, then, may achieve much the same results as elaborate price-fixing. The impact of cyclical or secular depression may be mitigated. Either approach may be so administered as to hinder more or less secular adjustments. The control of ouput and central selling appears, however, to be less likely to induce rigidities in price relations and to promote wasteful competitive methods. Moreover, this approach appears to have substantial administrative advantages.

THE BUDGETARY EXPERIENCE OF GREAT BRITAIN IN THE GREAT DEPRESSION[1]

George Jászi

THROUGHOUT the Great Depression England pursued an orthodox fiscal policy aiming at budgetary balance. She achieved a remarkable economic recovery without resorting to a policy of pump-priming deficits. It is the aim of this paper to examine how far the British were actually successful in their attempt to balance the budget; to set forth the factors which made the pursuit of an orthodox budgetary policy possible; and to see whether any general lesson can be derived from the British experience.

BALANCING THE BUDGET, 1930–31 TO 1933–34

Table I shows that during the Great Depression the British budget was never far from nominal balance. But in England, as in other countries, the nominal budget surplus or deficit is not a true indicator of the type of balance in which we are primarily interested. We are looking for a measure of the volume of net spending which the government adds to, or subtracts from, the spending of the community. As a first approximation to this we want to find the change in the indebtedness of the government, and add to this its disbursement of capital funds.

The nominal budget figures require, therefore, several corrections. In the first place, the Chancellor's statement includes provision for debt retirement as an expenditure, so that the nominal amount of surplus or deficit is arrived at after such provision has been made. For our purposes, we are interested in surplus or deficit before such provision. In the second place, it has at times been the practice of the government to draw upon capital funds to meet current expenditures. This practice does not give rise to a nominal excess of expenditures over receipts. For our purposes it should do so. Third, there is an odd practice in Great Britain that assumes some quantitative importance in

[1] I am indebted to Professor Alvin H. Hansen for much that is contained in this paper. In particular, he suggested that I explore the relation between public finance and the apportionment of national income between consumption and investment. He is, however, not responsible for the views I have expressed.

certain years. Authorities will sometimes borrow in order to pay interest on postal saving certificates. These transactions do not appear in the budget. Fourth, and more important, there are various funds which are outside the orbit of the budget, but which are under the control of the central government and which should be included in a full survey of its financial status. Most important among these are the social insurance funds. Their net position is included in the statement that follows. It should, however, be remembered that there are some other funds in the background of which I have not been able to take account.[2] I do not believe that they played any significant role in the period under consideration. Had they incurred any substantial deficits, their finances would most likely have come to public attention, like those of the Unemployment Insurance Fund. Nevertheless, their omission is a possible source of error. Fifth, there are issues and retirements of debt under specific acts of Parliament which do not appear in the ordinary budget. Table 1 summarizes all these items. It shows that at no time during the depression have there been deficits — either open or hidden — of substantial size.[2a]

TABLE 1

BORROWING AND DISSAVING OF BRITISH CENTRAL GOVERNMENT, 1930–31 TO 1934–35

(*£ millions*)

	1930–1931	1931–1932	1932–1933	1933–1934	1934–1935
1. Nominal budget deficit	23	..	32	−31	−8
2. Allocation to sinking fund (−)	−67	−33	−26	−8	−12
3. Borrowing for saving certificates	4	8	3	..	..
4. Capital funds used for revenue	..	9	..	10	..
5. Social insurance funds: Excess of payments over receipts	32	39	5	−4	−7
6. Increase in other indebtedness	6	5	4	..	1
Total Net Borrowing and Dissaving	−2	28	18	−33	−26

Source: U. K. Hicks, *The Finance of British Government* (Oxford University Press, 1938), p. 289.

[2] For the whole question of funds, cf. *Economist* (London), November 6, 1937.

[2a] Statistics on the finances of local authorities are unsatisfactory. Such figures as are available indicate that local authorities also pursued a budget-balancing policy. They do not support the view that deficit financing by local authorities took the place of central government deficits, or that borrowing by local authorities played a part either in mitigating the depression or in initiating the subsequent recovery.

How was this achieved? A short survey of depression budgets will give a partial answer and will suggest some further paths of exploration along which more adequate explanation can be found.

The budgetary crisis came to a head in the fall of 1931, just before the abandonment of the gold standard. Its approach had been heralded by the continued borrowings of the Unemployment Insurance Fund and by the fall of revenues. In the budget estimates of April 1931 the situation had been glossed over by disregarding the finances of the Unemployment Insurance Fund, making an over-optimistic forecast of prospective revenues and by bridging the remaining gap partly by taxation, but more largely by such makeshift devices as advancing the date of income tax payments and drawing heavily on the so-called Dollar Exchange Reserve Fund.[3] In September it became apparent that the situation needed more fundamental treatment. Revenues had been overestimated. The Hoover moratorium had further upset the April calculations. Also, it was decided to incorporate the Unemployment Insurance Fund into the budget instead of letting it drift independently on the sea of borrowing. A nominal budget deficit of 75 million pounds, or (taking account of the draft on the Dollar Exchange Fund and of the borrowings of the Unemployment Insurance Fund up to September, but deducting provision for debt retirement) of about 90 million pounds was anticipated for the financial year 1931–32.[4] This was approximately 10 per cent of estimated expenditures.

The government proposed to meet the situation in the following manner. No attempt was made to substitute regular tax revenues for the makeshift sources which had been marshaled in the April budget, or to extinguish the deficit already incurred by the Unemployment Insurance Fund. On the other hand, it was

[3] *Economist* (London), Budget Supplement, April 9, 1932.

[4]

	£ millions
Prospective nominal deficit (September estimate) owing to shortfall of revenues, net cost of Hoover moratorium, and incorporation of Unemployment Insurance Fund and Road Fund into Budget ..	74.8
Deduct: Allocation to Sinking Fund	46.2
Net deficit	28.6
Add: Borrowing of U.I.F. to September	39.6
Add: Draft on Dollar Exchange Fund	20.0
Comprehensive deficit	88.2

Cf. *Economist* (London), September 12, 1931 and April 9, 1932, Budget Supplement.

decided to stop all further borrowing, and to meet all further expenditures out of current revenue, achieving nominal budget balance with some provision for debt retirement at the end of the year. This necessitated additional taxation and retrenchment of expenditures to cover the gap of 75 million pounds.[5]

There is no purpose in tracing the manner in which this plan was modified in matters of detail by subsequent events. The essential features stand out clearly: in the second half of the financial year the budget was balanced by heavy additional taxation and a severe retrenchment of expenditures. No further deficits were incurred. The *Economist*, which in September 1931 had quoted with approval Prime Minister MacDonald's saying that it was "Far, far better for all of us to go with tight belts into stability than with loose ones into confusion,"[6] commented with enthusiasm and satisfaction that "the country may well congratulate itself upon a very remarkable achievement."[7]

But could it really be said that the attempt had been successful? Was not half a year too short a period to tell? Did not everything depend on the further course of national income? Would not the deflationary effects of increased taxation and reduced expenditures destroy the balance precariously achieved? We have to pursue our review a step further.

As a matter of fact, national income did not shrink significantly. No striking shift in the situation occurred. The 1932–33 budget

	£ millions
[5] Unemployment Insurance Fund: Increase of contributions, reduction of benefits; economies in expenditures on roads, education, defense, salaries, etc.	22.0
Reduction of sinking fund	13.8
Additional taxation on Commodities	11.5
on Incomes	29.0
Additional taxation and economies	76.3

The yield for the whole financial year of the additional taxation and of economies was estimated as follows (£ millions):

Taxation		*Economies*	
Contributions to U.I.F.	10.0	Unemployment benefits	26.3
Customs and Excise	24.0	All others	33.7
Income and Surtax	57.5	Total	60.0
Total	91.5		

Economist (London), September 12, 1931.

[6] September 12, 1931.

[7] April 2, 1932.

did not provide for further economies in the supply services, and only minor additional taxation was imposed. Revenues continued to shrink, their movement lagging behind the movement of incomes, and relief expenditures grew as the state of unemployment became prolonged. The deficit which would have developed was kept down to modest proportions mainly by the receipts from the protective tariff imposed in the spring of 1932 and some savings on the service of the national debt.

The *Economist* was less generous in its admiration.[8] The "grim balance sheet of the crisis," it said, referring to the budget estimates, "bleakly presented in a cold and comfortless speech . . . merits respect for its integrity but leaves enthusiasm unstirred."

We have to follow the fate of the budget only one step further. The key to the financial year 1933–34 was the huge savings, owing to conversion, on the service of the national debt. This made it possible to balance the budget in spite of the fact that a further fall of revenues was anticipated, and that unemployment expenditures continued to expand. But in spite of these savings the Chancellor found it necessary to make a further draft of 10 million pounds on the Dollar Exchange Fund in order to make both ends meet. There seemed to be a tendency away from orthodox deflation, an attempt to ease the burden of taxation, a feeling that budget balancing could not be pursued further unless there occurred some change in the situation.

The *Economist*, which in 1931–32 had been inspired by budget balancing, and in 1932–33 had paid its somewhat sullen respect to that grim principle, became openly critical toward the very same policy.[9] It remarked with some malice that, "faced with the shrinkage of revenue and the evidence of decreasing yields which dominate the accounts, he (the Chancellor) had to abandon budgetary purism — only to be inhibited by innate conservative caution from the 'expansionism' which is the only alternative to a ruthlessly logical, but politically impracticable deflation of expenditure. . . . To us the most disquieting aspect of Mr. Chamberlain's speech was the absence of any sign that the Government even now appreciates that, unless the national income expands, a balanced Budget on a £700 million scale — and that, too, after realizing all the possible savings from conversions and low interest

[8] April 23, 1932.
[9] April 29, 1933.

rates — becomes a patent impossibility." The Chancellor "gave no indication that the Government are even thinking seriously of any bold scheme of housing or other productive 'works.' . . . A Government which lacks the will or the courage to stimulate economic activity by a bold loan policy outside the Budget gives the Budget-maker an impossible task."

This was the verdict on orthodox budgetary policy in the third year of its operation. It is interesting to speculate what would have happened if national income had continued at its relatively low level. But we can do no more than speculate. Revival became perceptible during the year under review, and by the end of the year the tide of expanding revenues was submerging the "Budget Problem" and making Mr. Chamberlain's policy successful.

Let us summarize our conclusions regarding the more technical aspects of balancing the budget, add a few remarks which could not be fitted in hitherto, and pose some broader questions regarding the general setting in which balancing took place.

First, we found that throughout the period the budget was never far from balance. This is true whether we interpret balance in the narrow sense of the budget accountant or in the broader sense we have used.

Second, we saw that in 1931–32 balance was achieved by the orthodox methods of cutting regular supply services and increasing the rates of taxation on regular sources of revenue. But we also noted that no further economies were made in subsequent years and no new significant taxation imposed, while revenues continued to shrink and unemployment expenditures to expand.

Third, we found that a renewed unbalancing of the budget was prevented by the emergence of certain factors rather peculiar to the position of Great Britain. We noticed the great importance of the conversion operations in reducing expenditures. Interest on the national debt seems to be an ideal item to cut in times of depression without fear of deflationary effects; Great Britain was rather fortunate to have such a large national debt. This debt is held by large financial institutions and wealthy individuals who are not likely to reduce their expenditures if their interest income is cut. More than this, in so far as the savings of the debt service were not reflected in lower total expenditures but were used, say, for the relief of the unemployed, the result may actually have

been expansionary. Such a redirection of expenditures actually occurred in all the years of the depression. Savings on the service of the national debt were only partly swallowed by declining receipts. The rest were transferred to the unemployed. But this leads to the redistributive effects of government finance, a topic which will be taken up in the next section.

We also noticed the importance of the new protective tariff. This device, too, is exceptional in that it represents a mode of taxation which is likely to encourage production. Great Britain was fortunate to have a free trade system, which she could abandon. It is not easy to assess the relative importance of ordinary economies and additional taxation on the one hand and of the savings from conversion and the revenue from the protective tariff on the other. I should say that they were of the same order of magnitude, but that the latter sources were of somewhat greater importance.[10]

Fourth, certain obiter dicta regarding differences between the British and American tax systems may not be completely out of place. The American government during the twenties relied on income and supertaxes for a far greater proportion of its revenues than the British government. In the United States that proportion was more than one-half; in Great Britain it was about one-third. But not only did the British government in this way depend less on a rather sensitive tax. There is additional reason to believe that British income taxation is less sensitive to the business cycle than its American counterpart, because it relies more heavily on the stable lower incomes, and because it does not allow for capital gains.

Having enumerated all these factors, which were important in a minor way in making budget-balancing possible, we still have not referred to the two main pillars on which the success of that policy rested. The first of these is that national income did not drop sharply between 1929 and 1931, and that it ceased to shrink appreciably in 1932.

[10] A rough comparison would be as follows: Increased taxation, exclusive of protective duties, imposed during the depression was estimated to yield roughly 100 million pounds per annum. Economies were expected to yield 60 million pounds, but, as far as one can gather from scattered remarks and figures in the *Economist*, were realized only to the extent of about 50 million pounds. On the other hand, savings on the service of the national debt amounted to approximately 140 million pounds, and the annual receipts from the protective tariff were estimated at 35 million pounds by the Chancellor of the Exchequer.

TABLE 2

INDEX NUMBERS OF NET NATIONAL INCOME

	United Kingdom	United States
1929	100	100
1931	87	67
1932	84	48
1933	85	47

Sources: Colin Clark, *Economic Journal*, September 1938, and Simon Kuznets, *National Income and Capital Formation* (New York, 1937).

Had British incomes dropped more sharply, or had they continued to fall, there can be little doubt that the policy would have failed. The second is the revival of 1933–34. We have seen that the absence of further substantial contraction was not a sufficient condition of success. The changing attitude of the *Economist* and the tendency away from rigid orthodoxy faintly perceptible in the last pre-revival budget point to the conclusion that the final success of the balancing policy came only with the revival of 1933–34.

There are thus two central questions on which we have to throw light in order to see British budget policy in its full setting: First, why was the shrinkage of British national income so mild and so short? Second, what were the main factors in the revival of 1933–34?

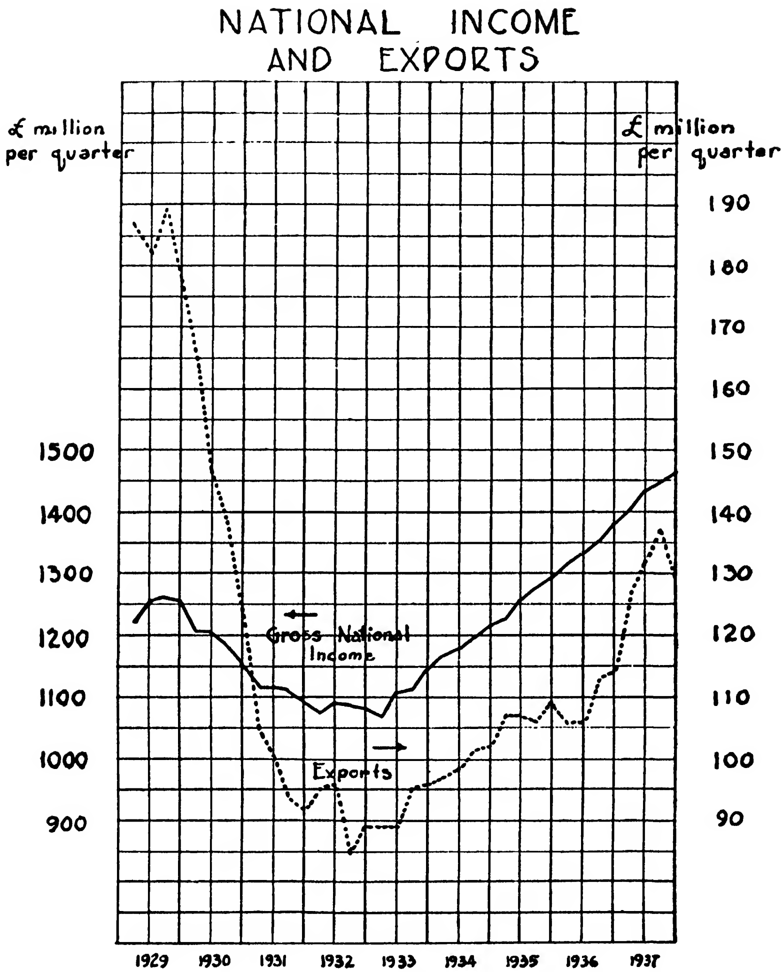
REASONS FOR STABILITY: DEVALUATION

In looking for an explanation of the stability of British national income after 1931, one naturally turns to devaluation. Chart I shows that the fall of exports was arrested after the devaluation of the pound in the autumn of 1931, and that national income, in turn, ceased to shrink after the fall of exports had been arrested. There seems to be a strong prima facie case for attributing importance to devaluation.

I shall not attempt to assess the role of devaluation in this paper. For my purposes two remarks will be sufficient.

If it was devaluation which stopped the fall of exports and, indirectly, of national income, and so allowed the balancing of the budget, this would tend to lead to the conclusion that the British experience was unique and not capable of general imitation — not even by the British themselves. The policy of devaluation consists essentially of lifting oneself by stepping on the shoulders of one's neighbors and can be successful only if the

CHART I



Source: Colin Clark, *Economic Journal*, September 1938.

neighbors acquiesce. In 1931 devaluation was not known as an instrument of cyclical policy, and not intended to be one by Great Britain. And many countries were hesitant to leave the firm anchor of gold. Hence the necessary conditions of acquiescence existed. But, after the orgy of devaluations which subsequently took place, it is unlikely that in future depressions nations will be allowed to benefit from devaluation. Thus, in so far as the

balancing of the budget indirectly depended upon devaluation, we must, I think, register the opinion that it was made possible by a unique setting not likely to recur.

Secondly, however, it seems to me that the suggested relation between national income and exports does not provide an explanation, but rather points to a new question. Is it not remarkable that national income ceased to contract once exports ceased to fall? We gain the impression that the cyclical decline in Great Britain was largely a foreign-trade affair, and that the internal system was characterized by great stability and the absence of deflationary forces. For that internal stability we must attempt to account.

REASONS FOR STABILITY: PUBLIC FINANCE

In Great Britain a very large percentage of national income is taxed away and spent by the government. Table 3 shows total

TABLE 3

Taxation as Percentage of National Income

	United Kingdom			United States		
	Total	Central	Local	Total	Federal	Other
1903	10.8	7.4	3.4	6.7	2.5	4.2
1913	11.8	8.3	3.5	6.4	1.9	4.5
1924	22.0	18.2	3.8	11.7	4.8	6.9
1934	24.8	20.4	4.4	17.4	5.7	11.7

Sources: National Industrial Conference Board, *Cost of Government in the United States*, 1929–30, p. 78 and 1934–36, p. 39. United Kingdom figures of taxation from Hicks, *op. cit.*, and *Statistical Abstract for the United Kingdom*. National Income figures from A. L. Bowley, *Wages and Income in the United Kingdom Since 1860* (Cambridge University Press, 1937).

tax receipts of central and local governments taken together and separately as percentage of national income for certain pre- and post-war years. For the sake of comparison similar figures are given for the United States. Whereas in pre-war years only one-tenth of national income was taxed away in Great Britain, in post-war years that proportion had grown to between one-fifth and one-quarter of national income. It is clear that the taxing away of such a large part of national income will have profound effects on the economic system — effects which will depend on the manner of taxation and on the way in which these funds are spent. But, before we begin to examine these effects, let us ask

whether a budget, large in proportion to national income, is of significance per se — whether, in other words, the existence of a large budget, irrespective of how the taxes are raised and spent, is likely to influence the behavior of the economic system.

Assuming that the stability of an economic system depends to a large extent upon the relative shares of investment and consumption in the national income (the system being more liable to fluctuations if the share of investment is large), it might seem that a large budget would have no effect on the stability of the system so long as it did not modify the proportion of consumption and investment. But this is not so.

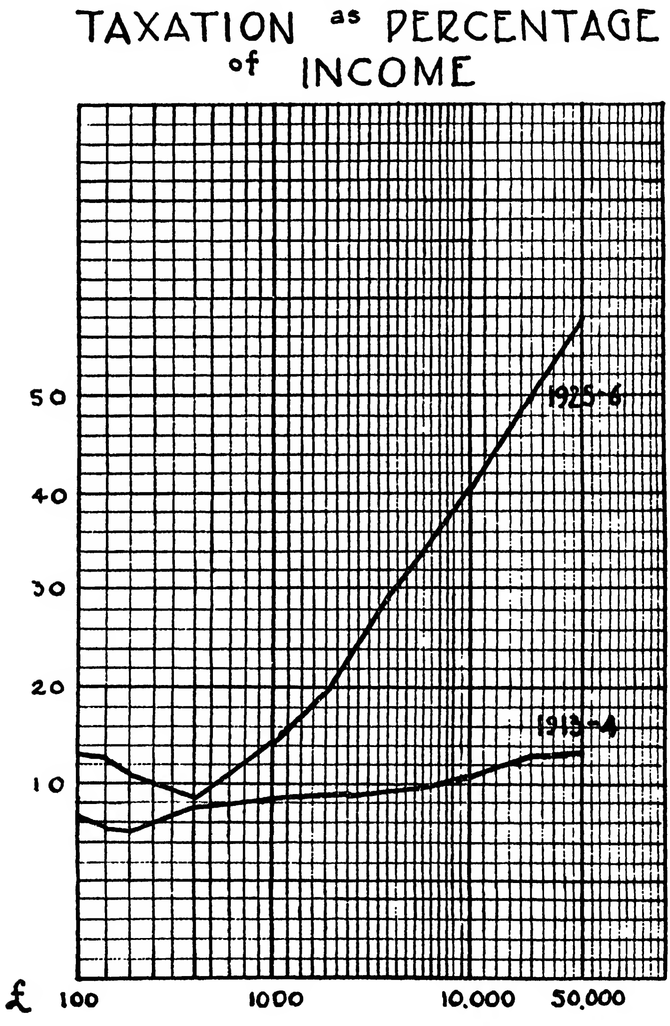
In the first place, investment by the government is likely to be more stable than investment undertaken by private individuals. This is so because the government is not guided by the profit motive. This view is not, I believe, controverted by the known fact that in actual practice government investment has tended to fluctuate with private investment. All that is suggested is that government investment is probably less sensitive than private investment, and that it is not likely to be the initiator of cyclical movements.

Secondly, a similar conclusion can also be drawn regarding expenditures on consumption. Private individuals can choose between consumption and hoarding. Although we may readily grant that hoarding in ordinary times is not likely to be an autonomous disturbing force, it is very likely that when for other reasons the economy has become entangled in a deflationary process, the exercise by individuals of their option to hoard will have a further disequilibrating effect. In such cases the existence of a large budget — that is, the fact that the government takes away a large part of individual incomes — limits the freedom to hoard. In times of depression an established system of heavy taxation is likely to be a stabilizing force.

Although the mere size of the money stream which passes through the hands of the government may thus be expected to have an effect on the behavior of the economic system, this is probably not the most important effect. In order to get a fuller view of the effects of public finance, we must examine the sources from which funds are raised and the manner in which they are expended. We are broadly aware of the fact that the system of British public finance is characterized by heavy progressive taxa-

tion and large expenditures on the social services. The tendency of such a system would be to increase the share of consumption in national income and to decrease the share of investment, thus adding to the stability of the economic system. This section of this paper will be given over to an attempt to judge in the light of the statistical material available whether the amounts involved in progressive taxation and social expenditures are of sufficient

CHART II



magnitude to warrant the belief that such a redistributive effect might be of quantitative importance, and to see whether available statistics give further support to our hypothesis.

There are presented in Chart II and Table 4 the estimates of the Colwyn Committee regarding the incidence of taxation on various sizes of income in 1913–14 and in 1925–26.

TABLE 4

TOTAL TAXATION AS PERCENTAGE OF INCOME
(Family of Two Adults and Three Minors)

Income (£)	Wholly Earned 1913–14	Wholly Earned 1925–26	Half Invested 1913–14	Half Invested 1925–26
50	8.0	..	8.8	..
100	5.4	11.9	6.6	13.0
150	4.4	11.6	5.6	12.7
200	4.0	10.2	5.3	11.3
500	4.4	6.2	7.1	8.4
1,000	5.2	11.0	8.3	14.4
2,000	4.9	15.2	8.4	19.3
5,000	6.7	23.2	9.6	29.5
10,000	8.0	31.2	11.8	40.1
20,000	8.3	37.5	13.0	48.7
50,000	8.4	44.4	13.6	57.7

Source: *Report of the Committee on National Debt and Taxation*, p. 95.

These estimates are based upon the fundamental assumption that direct taxes are borne by the payer and that indirect taxes are shifted to the consumer. They are incomplete, because they do not take into account local rates, stamp duties, certain import duties, motoring duties, and social insurance contributions. In many respects they are open to a large margin of doubt, either because (as in the case of indirect taxes) they are based upon inadequate statistics of consumption, or because the theoretical assumptions regarding incidence are somewhat shaky, or because of special difficulties that arose in making the computations (*e.g.* the transformation of death duties into equivalents of per annum taxation). Nevertheless, the story which they tell is so striking and unambiguous that it is not likely to be substantially modified either by a more complete coverage or by a different treatment of controversial points.

The table and diagram hardly need comment. Between 1913–14 and 1925–26 the British system of taxation was transformed from one which was roughly proportional or mildly progressive, according as we examine the taxation of incomes wholly earned or that of incomes half earned and half invested, into a system of taxation which is sharply progressive for the higher ranges of income.

We have, then, a very clear picture of heavily increased progressive taxation. Can we form an idea of the effects of this taxation

on the resources of various income classes? I have made a rough estimate of this sort for large incomes (Table 5). By applying

TABLE 5

TOTAL OF LARGE INCOMES, BEFORE AND AFTER TAXATION

Incomes (£ thousands)	Total Incomes Before Tax (£ millions) 1913–1914 (1)	Tax Rate (%) 1913–1914 (2)	Total Incomes After Tax (£ millions) 1913–1914 (3)	Total Incomes Before Tax (£ millions) 1925–1926 (4)	Tax Rate (%) 1925–1926 (5)	Total Incomes After Tax 1925–1926 (6)
2.0–	(27.0)	8	24.8	53.9	18	44.2
2.5–	(22.6) (107)	8	20.8	44.7	20	35.8
3.0–	(33.4)	8	30.7	66.0	23	50.8
4.0–	(24.0)	9	21.8	47.6	26	35.2
5.0–	(17.6)	9	16.0	36.2	29	25.7
6.0–	(14.0) 61.4	10	12.6	28.9	32	19.7
7.0–	(11.5)	10	10.4	23.6	34	15 6
8.0–	(18.3)	11	16.3	37.5	37	23.6
10.0–	28.9	12	25.4	58.1	41	34.3
15.0–	17.3	12	15.2	33.0	46	17.8
20.0–	11.5	13	10.0	22.3	49	11.4
25.0–	(6.8) 13.5	13	5.9	15.3	50	7.7
30.0–	(6.7)	13	5.8	(10.6) 21.2	52	5.1
35.0–	(4.5) 9.0	13	3.9	(10.6)	54	4.9
40.0–	(4.5)	13	3.9	(6.9) 13.8	55	3.1
45.0–	(3.4) 6.7	13	3.0	(6.9)	57	3.0
50.0–	(3.3)	14	2.8	(6.4)	58	2.7
55.0–	4.1	14	3.5	(6.4) 19.2	58	2.7
65.0–	2.9	14	2.5	(6.4)	58	2.7
75.0–	5.9	14	5.1	9.9	58	4.2
100.0–	14.4	14	12.4	29.1	58	12.2
Total	(282.6)		252.8	560.3		362.4

To the total of incomes of various size classes as assessed to supertax in 1913–14 and 1925–26 (columns 1 and 4) (Source: *Statistical Abstract for the United Kingdom*) have been applied the estimates of the Colwyn Committee regarding the incidence of direct taxation on incomes half invested (Columns 2 and 5), yielding net income after taxation (Columns 3 and 6). It was necessary to interpolate the estimates of the Colwyn Committee for size classes for which no estimates were made. In 1913–14 supertax statistics were not available for incomes between £2000 and £5000. It was assumed that the proportion which such incomes bore to corresponding incomes in 1925–26 was the same as the proportion which total incomes above £5000 in 1913–14 bore to corresponding incomes in 1925–26. To make the two distributions further comparable, total incomes were distributed among constituent size classes whenever they were given in a lump for several size classes together. In columns 1 and 4 figures in parentheses are estimates not to be found in the original data. It should also be noted that no correction has been made for the inclusion of Ireland in the pre-war figures. In view of the crudities described, it should be clear that the figures should not be used except for such broad qualitative conclusions as are expressed in this paper.

the percentage incidence of taxation on various income classes in 1913–14 and 1925–26, as estimated by the Colwyn Committee, to statistics of total income assessed to supertax in those two years, it was possible to calculate the net amount of large incomes left over to income recipients after the government had taken its share in taxation. In a footnote to the appended table, I have explained why no quantitative precision should be attributed to these calculations. Certain rather striking qualitative results, however, are clearly suggested.

It appears that receivers of incomes above £2,000 had at their disposal, after payment of taxes, larger sums of money in 1925–26 than in 1913–14. In the same period, however, the cost of living had risen by 70 per cent and wholesale prices by 60 per cent. Taking into account this huge fall in the purchasing power of money, we come to the conclusion that the command of large income receivers over resources in 1925–26 was substantially diminished as compared with 1913–14.

Moreover, the global figures hide significant differences. In the first few brackets of the distribution, the increase of money incomes may have been more than sufficient to offset the effects of increased taxation, even when account is taken of the fall in the purchasing power of money.[11] But as we pass higher along the scale we find very soon that although net incomes, after taxation, were larger after the war than before it, their increase was not sufficient to offset the fall in the purchasing power of money. Climbing still higher, we find that the absolute amounts left over after taxation were somewhat smaller in 1925–26 than in 1913–14, even if no allowance is made for the rise of prices.

Thus the statistics suggest that between 1913–14 and 1925–26 an unmistakable and very sharp impairment occurred in the position of the receivers of large incomes. Unfortunately it is not possible to pass from this to a corresponding conclusion regarding the savings of these classes, for their size is not known in either year. It has been usual to attribute great importance to the savings of large income receivers. In this special connection, such authorities as Professor Pigou [12] and the Colwyn Report should be mentioned. It is true that certain others have come to radically different conclusions. Mr. Colin Clark, for instance, asserts that

[11] The reasons for stating this conclusion in this guarded way are apparent from the footnote to the table.

[12] A. C. Pigou, *The Economic Position of Great Britain* (London, 1927).

"net private saving has ceased or become negative," [13] and that "large private incomes have ceased to count as a source of saving." [14] But the contradiction is only apparent. Mr. Clark's challenging estimates refer to the post-war period, and fit in rather well with the qualitative conclusions which we have reached. If we are willing to agree with current opinion that savings by large private income receivers were an important constituent of total savings before the war, we come to the conclusion that the changed position of large income receivers may have had a substantial effect on the saving propensities of the community.

But two provisos should be made. In the first place, undistributed profits of companies are not taxed at the high supertax rates. There must, therefore, have been an incentive to retain profits and to substitute corporate for private saving when the supertax was introduced. Such scanty information, however, as we have,[15] indicates that this did not occur. Corporate savings after the war had grown as compared with pre-war times, but not more than enough to catch up with the fall in the purchasing power of money.

Secondly, we have to take into account the changed resources of other classes. The working class is less interesting in this respect. It seems that the change in their position was not striking enough to affect their savings, which, in any event, probably form an unimportant part of the total.[16] There remain the middle classes and their savings. Although precise information is lacking, there are reasons for supposing that the position of these classes was substantially improved after the war. In the figures showing the relative incidence of taxation before and after the war, we notice a very significant feature: the so-called "middle-class dip." Rates of taxation on intermediate incomes were not much higher after the war than before it. If we assume that money incomes before taxation in these lower brackets had grown to the same extent as higher incomes did, these groups must have been considerably better off during the post-war decade. We

[13] Colin Clark, *National Income and Outlay* (London, 1937), p. xv.

[14] *Ibid.*, p. 191.

[15] Quoted by the Colwyn Committee.

[16] This impression is gained from reading A. L. Bowley, *Wages and Income in the United Kingdom Since 1860* (Cambridge University Press, 1937); A. L. Bowley and Sir Josiah Stamp, *Three Studies on the National Income* (London, 1938); Colin G. Clark, *National Income and Outlay* (London, 1937); and *Report of the Committee on National Debt and Taxation* (The Colwyn Committee).

have here, then, a possible additional source of savings, working to offset the decreased capacity to save of the very rich.

The impression I gain from this rather unsatisfactory survey is that it is by no means absurd to proceed on the hypothesis that the saving propensities of the community in the twenties were sensibly reduced as compared with the pre-war period. The available statistical material tends to support the view rather than to contradict it. It is, unfortunately, too scanty to yield precise quantitative results.

TABLE 6

PUBLIC EXPENDITURES, BY CENTRAL AND LOCAL GOVERNMENTS

	1913–14 (£ *millions*)	(%)	1930–31 (£ *millions*)	(%)	Increase (%)
Civil	20.2	6	50.8	4	252
National Debt	24.5	7	360.0	27	1470
Military	77.2	22	164.0	12	212
Social	118.5	35	483.1	36	407
Economic	101.8	30	282.2	21	276
Total	342.2		1340.1		390

Source: Hicks, *op. cit.* The above figures exclude loan expenditures.

The accompanying tables give some information regarding the manner in which increased tax receipts were spent. Table 6 shows public expenditures by central and local governments in 1913–14 and 1930–31, classified according to types of expenditure. Aside

TABLE 7

NATIONAL INCOME AND SOCIAL SERVICES

	National Income (£ *millions*)	Social Services (£ *millions*)	Social Services as per cent of National Income
1890–91	1335[a]	22.6	1.7
1900–01	1690[a]	36.0	2.1
1911–12	2060	63.2[b]	3.1
1924–25	4227	338.5	8.0
1934–35	4022	483.4	12.0

[a] Averages of periods 1886–90, 1891–95, and 1896–1900, 1901–05.
[b] 1910–11.

Social Services are exclusive of loan expenditures and include Unemployment Insurance, National Health Insurance, Pensions, Education, Public Health, Housing, Poor Relief, and Care of the Mentally Deficient.

Source: National Income: Bowley, *op. cit.*, Social Services: *Annual Return of Social Services.*

from the increase in the total and in the service of the national debt, the growth of the social services is its most marked feature. Table 7 (based upon a somewhat less comprehensive definition of these services) shows their growth and relation to national income over a longer period of time.

At the end of the last century expenditures on social services were barely 2 per cent of national income. Before the war they amounted to 3 per cent. By 1924–25 the figure stood at 8 per cent, a decade later at 12 per cent.

We have here, then, a massive flow of growing expenditures which can be expected to go on year after year. Our evidence regarding taxation already leads us to believe that at least part of this money comes from the wealthy. Mr. Colin Clark has attempted to calculate the amount of this redistribution more precisely (Table 8).

TABLE 8

EXPENDITURE AND TAXATION, CENTRAL AND LOCAL GOVERNMENTS

	1913–14	1925–26 (£ *millions*)	1935–36
Expenditures benefiting the—			
Well-to-do	36	336	263
Working classes	76	310	429
Taxes, borne by the—			
Well-to-do	172	663	685
Working classes	90	265	338

Source: Colin Clark, *National Income and Outlay*, ch. 6.

National Debt Service and Highways are taken to be expenditures benefiting the well-to-do. Unemployment Benefits and Assistance, Pensions, Public Assistance, Health Insurance Benefits, Education, Public Health Services, and Housing, the working classes. The usual assumptions are made regarding the incidence of taxation. The dividing line between the working classes and the well-to-do is drawn at £160 of annual income for pre-war times, and at £250 for the post-war period.

Clark estimates that in 1913–14 the structure of taxation and expenditures was such that the working classes contributed 14 million pounds more in taxation than they received in services directly beneficial to them. By 1924–25 the situation had been reversed. The working classes received 45 million pounds more in services than they paid in taxes. By 1935–36 the sum so redistributed had risen to 91 million pounds. Mrs. Hicks, while registering some doubt regarding the fundamental methodological assumptions of the estimates, is willing to raise the post-war figures to about 90 million pounds and 115 million pounds per

annum, on the basis of somewhat more comprehensive data which she uses.[17] I am inclined to believe that, had we taken a somewhat earlier pre-war year as the standard of our comparison, the shift would be even more striking. For in the years prior to 1913 social services were already expanding, while it is unlikely that a proportionate expansion in the type of taxation borne by the working classes was taking place.

I think it is legitimate to assume that, if control of these funds thus diverted to the use of the working classes had been left in the hands of the rich, they would at best have gone into less stable channels, mainly investment, contributing to the progress of the system but not to its stability. Or, if investment opportunities had been lacking, these funds might not have been spent at all, thus lowering the income of the country.

Income annually so redistributed as compared with pre-war years amounted to, say, 110 million pounds in 1925–26 and to 135 million pounds in 1935–36.[18] Net investment during the twenties was around 300 million pounds, and gross investment around 700 million pounds. The sum redistributed from the rich to the poor thus amounts to a very substantial fraction of net investment and to a considerable fraction of gross investment. Clearly, we are dealing not with incommensurables but with approximately equal forces. I do not know at present how to proceed from here toward a more precise measure of the added stability which the substitution of consumption for investment of approximately the above order of magnitude would give to an economic system. To find such a measure would clearly be necessary to give our hypothesis greater conviction.

In order to gauge the combined impact of taxation and expenditures, we have focused our attention on the social services and their redistributive effects. Was this a legitimate procedure? To obtain an idea of the effects of public finance on the consumption and investment of the community, would it not have been better to look for some other measure of the burden on the rich which would be more comprehensive — for example, the increase in their contribution to total expenditure?

[17] U. K. Hicks, *The Finance of British Government* (Oxford University Press, 1938), p. 59.

[18] The pre-war 14 million pounds are reckoned at their approximate post-war equivalent.

For certain types of expenditure this clearly would have been the wrong procedure. The huge increase in the service of the national debt, for instance, did not constitute a burden on the rich in the same way as the increase in social expenditures. For the money taken from them in the form of taxes was, broadly speaking, returned to them in the form of interest. Or take the economic services, which expanded 276 per cent between 1913–14 and 1930–31. These expenditures were made for the benefit of particular industries or industry in general. It would clearly be illegitimate to include taxes paid for these expenditures in assessing the tax burden on the well-to-do. This procedure would be just as absurd as deducting costs of production from a figure of net income in order to arrive at some queer new concept, which would be without significance. As a first approximation, at least, we must assume that these economic expenditures partook of the nature of ordinary costs incurred in the course of business, and that they raised the receipts of industry in more than corresponding proportion. For civil expenditures the case is less clear, and in the case of military expenditures this type of reasoning becomes inapplicable. But during the twenties military expenditures did not show a remarkable growth as compared with the pre-war period. And civil expenditures, although they increased rather more, form an insignificant part of the total. Hence we should not expect important effects on these counts. On closer examination, therefore, it seems justified to concentrate mainly on social expenditures and their redistributive effects, perhaps with the reservation in mind that concentrating on them will rather understate the effects of public finance on consumption and investment.

Does such information as we have regarding the apportionment of national income show a fall in the share of savings and investment such as we have been led to expect?

The measurement of saving and investment can be approached from two sides. An attempt can be made from the monetary side by adding up all known sources of savings to arrive at a comprehensive figure of national savings. The other approach is to study the output of the economic system and to separate out that part which is defined as investment. We have some evidence along both lines.

Several estimates have been made regarding the monetary savings of the British economy before and after the war. These

estimates can be found in the Reports of the Colwyn and Balfour committees and in Bowley's and Stamp's study of the national income in 1911 and 1924. They are conveniently summarized in Pigou, *The Economic Position of Great Britain* (London, 1927). In this pamphlet Pigou repeats the conclusion of earlier investigators that savings after the war had fallen off considerably as compared with pre-war times, and he links up this fall in quite unambiguous terms with the corresponding growth of social expenditures:

Thus, as against 1911, total savings fell from about 16 per cent, to 12 or 13 per cent of total social income: and that part devoted to home investment fell from 12 per cent to 10 per cent of home produced social income. The Balfour Committee puts the point thus. Savings *immediately* before the war (*i.e.* later than 1911) were estimated at £380 to £400 millions; at the price level of 1925 they would have amounted to some £600 to 650 millions; and in 1925 savings in fact fell short of this by £150 millions, or 25 per cent. Since savings through the undistributed profits of companies (amounting to £194 millions) were in real terms approximately constant, the whole of the drop must have been in the savings of individuals; and these must have declined in real terms some 35 per cent. It is interesting to note, although the point should not be stressed, that the £150 millions by which, on the above plan, the drop in savings is measured, is very nearly equal to the excess of social service expenditures (as defined above) in 1924 over 1911.

It might seem from this that Pigou is rather guarded in linking social expenditures and the fall of savings. That this is not so can readily be seen by consulting the original text. His caution above does not refer to the general relation of the two phenomena, but to the numerical coincidence to which he draws attention. It should be noted that Pigou also mentions the somewhat lower level of post-war incomes as another reason for the decline of savings. But he puts greater emphasis on the social services. The section on annual savings and the corresponding conclusions regarding the effects of the social services are omitted from the new edition of the pamphlet.[19] I think they are quite properly omitted. At the time these investigations were made, statistical material and theoretical notions about saving were even less satisfactory than today, and not much reliance can be placed upon these esti-

[19] A. C. Pigou and Colin Clark, *The Economic Position of Great Britain* (London, 1936).

mates. As far as they go, however, they would seem to confirm our hypothesis.

The approach from the real side was made by Mr. Colin Clark. There are given in Table 9 his estimates of gross and net capital formation, and the relation which capital formation bore to national income in 1907 and in certain post-war years.

TABLE 9

GROSS AND NET NATIONAL INCOME AND INVESTMENT

	Gross			Net		
	Income	Investment	Investment as per cent of Income	Income	Investment	Investment as per cent of Income
	(£ millions)			(£ millions)		
1907	2169	387	17.8	2030	248	12.2
1924	4376	668	15.3	4035	327	8.1
1929	4752	682	14.3	4384	314	7.2
	4994	722	14.5	(4626)	(354)	7.7
1937	5734	792	13.8	(5334)	(392)	7.35

Net figures for 1929 and 1937 are estimated by deducting £368 millions for 1929 (cf. *National Income and Outlay*, p. 185) and £400 millions for 1937 from the gross figures. The latter figure is the average figure for annual maintenance and depreciation for recent years, given by Mr. Clark in the *Economic Journal* for June 1937.

Sources: Colin Clark, *National Income and Outlay*. For second estimate for 1929 and for estimate for 1937: *Economic Journal*, September 1938. As far as I am aware, Mr. Clark has never disclosed the reasons for the considerable discrepancy between the two estimates for 1929.

We seem to have here what we were looking for. Gross investment, as a percentage of national income, fell from roughly 18 per cent in 1907 to 15 per cent in 1924, and to approximately 14 per cent in 1929 and 1937. The corresponding figures for net investment are 12 per cent, 8 per cent, and (say) 7 per cent.

But before we can accept these figures as supporting our hypothesis regarding the redistributive effects of the social services, we have to consider a possible objection. Upon closer examination, it appears that the decline in the proportion of income invested is largely due to the decline of foreign investment, i.e. in the amount of excess of current receipts over current expenditures in the balance of international payments. The proportion of income invested in domestic fixed capital actually shows an increase over the period. Now it is more than questionable whether the

amount of foreign investment thus defined depends on the inclination of Englishmen to save and to invest abroad. It seems more likely that it depends on the competitive position of the country, the extent to which it is capable of building up a favorable balance of international payments on current account. Yet should we not have to make the former rather than the latter assumption if we wished to forge a causal chain between the redistributive effects of public finance and the changed apportionment of income between consumption and investment?

An attempt might be made to argue along the following lines. In the earlier period, it might be said, the savings of the rich were handed over to borrowers who bought English goods and proceeded to export them for use in their investment activities in foreign lands. Thus foreign investment (in the sense of saving and investing in foreign securities) built up a favorable balance of payments on current account (i.e., foreign investment in the sense of national income statistics). The redistributive effects of public finance curtailed the amount of money lent to people desirous of exporting English goods and, by making more money available to the working classes, increased the volume of imports. Thus curtailment of foreign investment (in the sense of saving and investing in foreign securities) cut the favorable balance of payments on current account (i.e., the volume of foreign investment in the sense of national income statistics). This is a possible relation. But seen against the broad background of the decline in Great Britain's international competitive position, which furnishes so much simpler an explanation of the decline of foreign investment, it seems to lack conviction.

Fortunately, this rather tortuous argument is not needed. A simpler one is at hand. It may readily be admitted that the fall of foreign investment was unrelated to social expenditures. But, had the redistributive effect of social expenditures not been at work increasing the propensity to consume of the community, the shrinkage of national income would have been greater, so that the percentage which investment bore to income would not have fallen. To this it may be objected that the mere fall of income would lead to a fall in that percentage, because people will save less out of a smaller income. But the figures for 1937 prove that the lower percentage of investment to income in post-war years was not due to the low level of income. In 1937 the level of income was high, measured by any standards; yet the ratio of investment to

income showed a further fall as compared with 1924 and also with 1929.

I conclude, then, that the fact that the fall of the rate of investment to income was due to foreign investment does not lessen the value of the evidence which national income statistics furnish.

In this connection a comparison with the United States is of some interest. English and American figures (as computed by Clark and Kuznets) on national income, saving, and investment are not immediately comparable for the following main reasons: (1) English figures include indirect taxation; (2) they exclude interest on the national debt; (3) they include maintenance and repair work in gross investment. The last, of course, is a small item in the total, but an important part of gross investment, and hence important in comparisons of the relation which investment bears to income; the American figures exclude maintenance and repair work, other than constructional, from gross investment. If an attempt is made to make the statistics comparable by adjusting the English figures for the three divergences enumerated, an interesting result is revealed. Throughout the post-war period (the only period for which American data are available) investment formed a considerably smaller portion of income in England than in the United States. During the twenties gross investment was generally over 20 per cent of income in the United States and around 13 per cent in England. The corresponding figures for net investment were between 10 and 14 per cent in the United States and between 7 and 8 per cent in England. This would suggest that the English system was less prone to fluctuations than the American system.

Virtually all economic series point towards the same conclusion. They all exhibit the greater stability of England and the greater scope for instability and volatility of the United States. On the other hand, it seems strange that investment should form a larger proportion of income in a country in which agriculture is still of great importance than in a country which was known as the workshop of the world, and in which agriculture has dwindled to small proportions. I hesitate, therefore, to draw any final conclusion from these figures. They might yield interesting results upon further investigation — either regarding the different structure of the British and American economy, or regarding the incomparability of national income statistics.

We have examined the hypothesis that the system of public finance may have imparted a certain stability to the British economic system, mainly by encouraging stable consumption at the expense of unstable investment. I think that the available statistical material suggests that a substantial amount of such redistribution has occurred. But I realize that I have not made progress toward measuring the degree of added stability which an economic system would derive from such a redistribution.

REASONS FOR STABILITY: STAGNATION

There is another and simpler reason for the stability of Great Britain during the last depression. This is her comparative stagnation during the twenties. Economic activity did not climb to the high peaks of a major boom in 1929. The scope for subsequent shrinkage was smaller.

It is not my intention to give a systematic account of that stagnation. But I shall give a rather impressionistic enumeration of its most significant features in order to round out our picture of the setting in which British budgetary policy operated.[20]

We know that the main symptom of that stagnation was a large volume of chronic unemployment throughout the twenties. For the care and administration of this unemployment extensive organizations were developed. The new blow of the Great Depression did not confront England with a new problem, and did not necessitate the setting-up of entirely new agencies, and the expenditures associated with such a complete change.

The causes of unemployment are well known, too. It was mainly concentrated in the big exporting industries, such as coal, iron and steel, shipbuilding, and textiles. These industries were suffering from the dislocation of the war, from increased foreign competition, the industrialization of backward nations, and the associated protectionism. Fundamental changes in technique, such as occurred in the iron and steel industry, and the substitution of water power and oil for coal, were striking at the very heart of the British position.

Equipment in mines, iron and steel, and textiles was old-fashioned. No adequate attempts were made to modernize it. Partly this was due to inertia. But in many cases it might not have been

[20] Much of the subsequent account can be found in G. C. Allen, *British Industries and Their Organization* (London, 1933), and, in a suggestive but less reliable fashion, in André Siegfried, *England's Crisis* (London, 1933).

good business to modernize. It might not have paid to install expensive mechanical equipment in mines that were nearing exhaustion; and, although it might have been profitable to install modern textile equipment had one been first in the field, it might no longer have been so once a foreign competitor had captured the market.

Vicious circles established themselves. New equipment was not installed because prospective trade was shrinking, and trade was shrinking because new equipment was not installed. Firms lacked funds with which to buy machinery, or the financial status to borrow; and the fact that they did not buy machinery resulted in further deterioration of their position and borrowing power.

Organization, as well as equipment, was old-fashioned. In the era of British world monopoly, which generally goes under the name of world-wide free trade and competition, Great Britain did not have to worry about effective selling technique and organization. With the rise of international competition these became of great importance, and Great Britain was found wanting. There are many examples during the twenties of this particular deficiency.

Superimposed upon these difficulties, there were other aggravating factors, also well known. The return to gold in 1925 raised the cost of British goods to Britain's international customers at the very time when it was particularly essential to reduce them. The rigidity of British wages, undoubtedly supported by the extensive system of social services, made it impossible to correct this. Heavy taxation was reducing the net yield of investment, and may also have caused a shortage of funds, especially in the case of businesses that had no ready access to the capital market. The exigencies of the international standard, the huge national debt, and the high yield that could be earned on rather questionable foreign securities kept interest rates high and constituted a check on investment opportunities which would have been eligible at lower rates of interest.

This was not the setting for a violent decline.

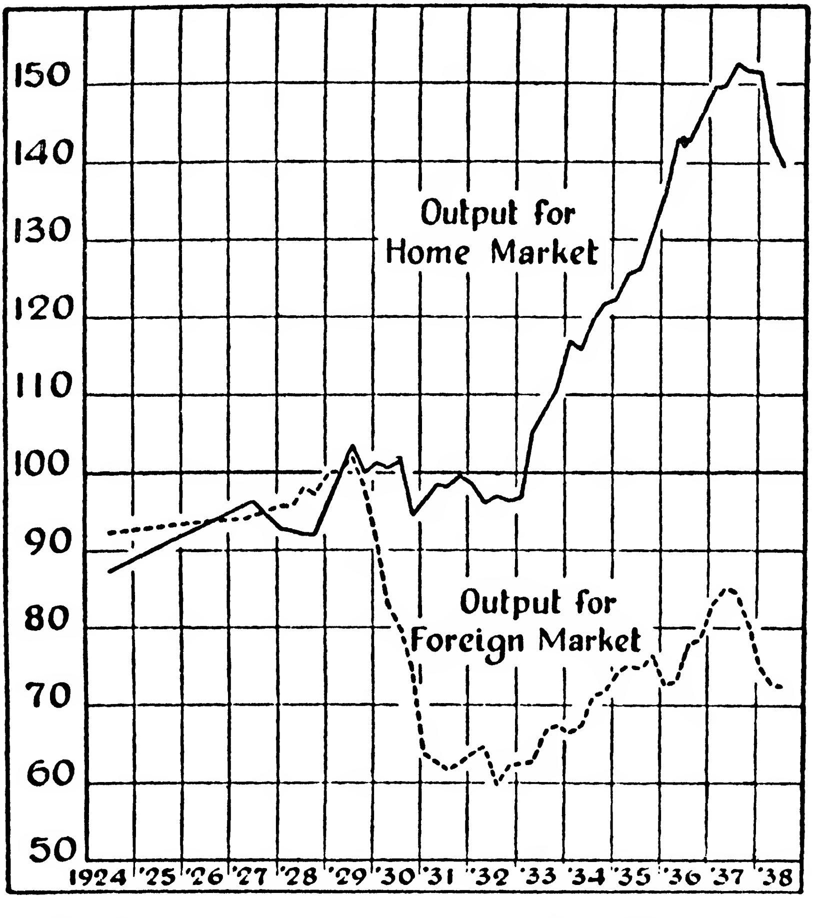
STRATEGIC FACTORS IN THE RECOVERY

If consumption constitutes a large share of national income, the forces of recovery have an easier task because a smaller volume of investment will be sufficient to secure full employment. With this consideration in mind, let us sketch the strategic factors of the

CHART III

PRODUCTION FOR THE HOME AND FOREIGN MARKETS

(1929=100)



The basic material on which these estimates are based consists of the Board of Trade's indices of total industrial output and of the volume of exports (both have been corrected for seasonal fluctuations and for the varying number of working days). The indices were converted into value figures on the basis of (*a*) Mr. Colin Clark's estimate of the value in 1930 of the output covered by the Board of Trade index (including building), and (*b*) the value of total British exports in 1930. The difference between the value of output at 1930 prices and the value of exports at 1930 prices was taken to be the value of production for the home market at 1930 prices.

Source: *Economist* (London), December 24, 1938.

recovery of the thirties. This will complete our survey of the setting in which British budgetary policy operated. Chart III is the most telling summary of that recovery, and at the same time it brings out clearly certain features of the situation which we have already discussed.

The chart shows the relative course of industrial production for the home market and for export markets in the period 1924 to 1937. It exhibits clearly, in the first place, the absence of a boom in the twenties. It shows, secondly, what Chart II comparing the course of exports and of national income seemed to suggest — that in England the Great Depression was purely a foreign trade affair. Between 1929 and 1931 the volume of exports dropped 40 per cent; production for the domestic market was hardly affected. Thirdly, it brings out clearly the nature of subsequent recovery. Beginning with 1933 production both for the domestic market and for the foreign market began a steady improvement. But whereas in 1937, at the height of the boom, exports were still 15 per cent below the 1929 level, production for the home market exceeded that level by more than 50 per cent.

The limitations of these estimates should be borne in mind. The indexes refer to industrial production only. The inclusion of the distributive and service industries would considerably reduce the slope of the domestic line, since the expansion of these industries since 1929 was certainly less than 50 per cent. The total rise of such a comprehensive home index might be 30 per cent.[21] On the other hand, the statistics on which the graph is based take inadequate account of the volume of constructional output. Owing to the building boom, the rise in the volume of construction was more marked in the period under consideration than in any other line of industrial activity, and a more comprehensive coverage of that sector would offset to some degree the effects of the inclusion of the service industries.

But these are questions of detail. The essential features stand out. The recent British recovery is the result of a unique shift of emphasis away from the export markets toward the home market. During the twenties Great Britain was stunned by the decline of her foreign markets. The thirties represent the liberation, discovery, and conscious fostering of the home market, with a considerable element of sheer good luck added. The main factors, as I see them, are as follows.

[21] *Economist* (London), January 7, 1939.

The devaluation of the pound in 1931 and the balancing of the budget in 1932 made possible the conversion operations and the cheap-money policy initiated in that year. This liberated the economy from the chains of high interest rates. Cheap money is almost universally discredited today. Hardly anyone believes in its efficacy in stimulating recovery. And rightly so. If investment has proceeded on a high level for a number of years and investment opportunities, for the time being, are exhausted, low interest rates will indeed be impotent. But in Great Britain this was not the case. We have every reason to believe that high interest rates during the twenties kept investment in check. The removal of this obstacle may have been an important factor in subsequent recovery.

The home market was actively fostered by further measures. Three of them should be mentioned in this connection. Devaluation, to the extent that it was not offset by parallel action abroad, made it cheaper to buy certain commodities in the domestic market. The adoption of the protective tariff in 1932 was a second and, probably, more effective measure. Third, the embargo on foreign loans meant that more funds had to look for investment in the home market.

In addition to this, it is my impression that a more subtle process of rediscovery of the home market was going on. Owing to the old traditions, British capital had been essentially internationally minded, looking abroad for investment opportunities. Even in the twenties when the export industries, which provided the real foundation of that international orientation, were already in a period of decline, investment in foreign securities continued to be profitable. And there was always the opportunity of investing passively in the government debt, which was yielding high rates of interest. In 1932 the situation had changed radically. The opportunity for foreign investment ceased — not only because of the embargo but also because of the general economic and political situation abroad. Simultaneously, the interest rate which could be earned on government debt was radically cut. Investors had to look for new uses of their money. Active exploitation of the home market provided the only opportunity. Once the home market was discovered, it proved to be a mine of unexpected fertility.

Finally, there was a factor which we must consider at somewhat greater length, because it involves some theoretical complexities. I refer to the shift in the terms of trade in favor of Great Britain which occurred in the last depression.

TABLE 10

PURCHASING POWER OF BRITISH GOODS OVER FOREIGN GOODS

(1929: 100)

1930	108.4	1934	121.7
1931	119.9	1935	119.6
1932	119.9	1936	114.8
1933	124.7	1937	109.1

These index numbers were calculated by dividing an index of the average value of retained imports into an index of the average value of exports of United Kingdom produce. Since continuous indexes are available only for the period 1930 to 1936 the figures for 1929 and 1937 are subject to a margin of error. Source: *Statistical Abstract for the United Kingdom.*

Owing to the great fall in the prices of imported foods and raw materials, and the relative stability of the prices of manufactured exports, the purchasing power of British over foreign commodities increased by 25 per cent at the depth of the Great Depression.

This change in the terms of trade, it is frequently said, constituted a powerful and independent force for domestic recovery. The argument, as presented, for instance, by the *Economist*,[22] which linked the building boom with the change in the terms of trade, may be stated as follows. Owing to cheap food and clothing during the depression, Englishmen had an ample margin of free purchasing power after they had bought their usual requirements of these commodities. This free margin they proceeded to spend on houses, automobiles, and other domestic commodities, powerfully adding to, or perhaps even initiating, the recovery of the thirties. According to the *Economist*, "The wage and salary earners of the nation, after buying their food, drink, tobacco, and clothes had something like £250 millions a year *more* left over in 1932 than in 1924–27." This is clearly a substantial sum. Spent upon domestic commodities, it can be expected to have powerful effects.

But let us examine the argument more closely before we give it final assent. Had we before us a country where the producers of agricultural commodities and raw materials were situated within the national boundaries, nobody would assert that a sharp and sudden fall in the prices of agricultural products and raw materials would create a situation favorable to a boom. Why, then, should the effects of the same phenomenon be favorable to Great Britain?

The fact that agricultural and raw material producers are located outside Britain is not a sufficient condition for such bene-

[22] October 26, 1935.

ficial effects to occur. If the fall in the purchasing power of these producers, which is the result of the lower value of their produce, leads to a corresponding fall in their takings of English exports, there is no prima facie reason to believe that the British economy will be stimulated. It is true that, if the demand of Englishmen for food and raw materials is inelastic, they will have to devote less of their resources to the production of export commodities in order to obtain the imports they desire. Some resources will be set free for production for the home market. It may also be reasonable to assume that these resources will tend to be employed for home production rather than remain idle. But we have not yet found any trace of the supposed stimulative effect of the change in the terms of trade. So far what it all comes to is a shift of demand from export to home production. It seems necessary to introduce further assumptions.

Two such assumptions can be made. In the first place, it can be assumed that there is a certain lag between the fall of imports and the time when such a fall is reflected in a fall of exports. If this is the case, there will be a net expansive effect. Clearly, the assumption is not unreasonable. Such lags can develop for several reasons. Agricultural and raw material producing countries may not immediately adjust their standards to their impaired position. They may dishoard and so maintain their purchases. Or the fall in their purchases may be spread widely over many countries, so that the effects on any one country are mild.

Do the statistics warrant the assumption that such a lag did occur? [23] No indications of a lag appeared in 1930 and 1931. Imports and exports fell headlong together and the import sur-

[23] The relevant figures run as follows:

BRITISH FOREIGN TRADE
(£ *millions*)

	Retained Imports	Exports of U. K. produce	Import Surplus
1929	1,111	729	382
1930	957	571	386
1931	797	391	406
1932	651	365	286
1933	626	368	258

		Retained Imports	
	Food	Raw Materials	Manufactures
1931	397	148	244
1932	358	141	145
1933	328	155	139

Source: *Statistical Abstract for the United Kingdom.*

plus oscillated around 400 million pounds. In 1932, however, the fall of exports was checked, whereas imports continued to decline. In 1933 the situation was similar. The import surplus was reduced by about 150 million pounds between 1931 and 1933. The development of an apparent lag at this time fits in well with the timing of the revival. But can we say that the shift was due to the fact that the required quantity of primary products could be imported at lower prices? It seems that this is only partially true. A breakdown of imports reveals that the largest drop occurred in the category of manufactured articles. This drop is not connected with the change in the terms of trade but is probably to be related to the imposition of the protective tariff. We conclude, then, that the statistics do not completely contradict the hypothesis that the change in the terms of trade had a stimulative effect, through an "inflationary lag" between the fall of imports and exports. On the other hand, they do not suggest that this effect was of great importance.

There is a second relation which might cause the change in the terms of trade to have a stimulative effect. We saw that that change could best be pictured as a shift from English export products to English domestic products. We concluded, as a first approximation, that there was no reason to believe that such a shift in demand would have a net expansive effect. This conclusion has to be qualified. We must ask ourselves what will be the effects on investment of such a shift in demand. If demand shifts from a market which is already depressed to a market which is fairly active, it is probable that the net effect of the shift will be to stimulate investment. For the decrease in investment due to the shift from the market which is already depressed is likely to be less than the increase caused by the shift to the new market where activity is well maintained and existing capacity rather fully employed.[24] This was the case in the recent experience of England. The further deterioration of the already depressed export market probably did not result in a fall of investment commensurate to the increase of investment which was caused by the shift to the domestic market, especially to housing.

I conclude, then, that the argument, as we usually hear it, concerning the stimulative effects of the change in the terms of trade is substantially correct, although it is stated in a somewhat eliptical fashion.

[24] Gottfried Haberler, *Prosperity and Depression* (Geneva, 1938), pp. 92–93.

Although it is outside the scope of this paper to give a historical account of British recovery, it is tempting to make a specific reference to the housing boom, because it looms so large in that recovery, and because it assembles and brings into clear relief several of the tendencies described.

TABLE 11

HOUSES BUILT IN ENGLAND AND WALES

Average of Fiscal Years ending March 31	Total	Private Enterprise			Local Authorities (Largely State Assisted)
		Total	Unassisted	State Assisted	
			(in thousands)		
1927–29	209	131	63	68	78
1931	184	128	125	3	56
1935–37	333	277	276	1	55
			(1927–29: 100)		
1927–29	100	100	100	100	100
1931	88	98	199	4	72
1935–37	159	211	438	1	71

Source: *Statistical Abstract for the United Kingdom.*

Table 11 brings out the private and unassisted nature of the boom. In the three years in which the boom was near its peak, the total number of houses built in England and Wales was 59 per cent higher than in the three years preceding the Great Depression. Construction by private enterprise, however, was 211 per cent higher. The smaller rise in the total was due to the fact that construction by local authorities fell substantially. It appears, furthermore, that during the so-called depression private construction hardly declined in spite of the withdrawal of government subsidies. The moderate decline of 12 per cent in the total which occurred between 1927–29 and 1931, the low year, was entirely due to the fall in local government work. The absence of domestic deflationary forces and the great strength and resilience of the private market in face of unfavorable circumstances should be noted. We gain the impression of pent-up forces waiting to be released in order to blossom out into a full-fledged boom. Incidentally, it should be noted that in this case the only cyclical decline that occurred was attributable to government action. Our earlier conclusion that government investment is likely to be more stable than private investment certainly needs to be stated with qualifications.

Technically, the industry was in good shape for an expansion. Building societies with ample funds had developed during the twenties, and had made their terms more liberal and attractive.[25] The building trade itself was reorganized to take advantage of the economies of large-scale construction. The cost of building a three-bedroom house fell from £863 in 1920 to an approximate average of £400 in the years preceding depression, and to one of £300 during the building boom.[26]

As far as demand is concerned, there seems to have been present a latent demand for houses on the part of the middle and lower middle classes. There are indications that during the twenties these groups had increased in importance.[27] Their economic position was favorable because taxation bore comparatively lightly upon them, and because their occupations were largely connected with the relatively prosperous home market. Housing standards had risen, and a considerable amount of internal migration had taken place, creating a need for new houses in new places. All in all, the existence of this potential demand is not surprising.[28]

What happened subsequently I venture to reconstruct as follows. First, cheap food and cheap clothing made the position of the middle classes even more favorable and provided them with a free margin of purchasing power which they were willing to spend on housing. Second, cheap money acted as a stimulus. It is true that the mortgage rate of building societies did not fall substantially until after the boom had started. But this is not necessarily an argument against the importance of cheap money. For attention should be paid not only to mortgage rates but also to the funds which, owing to cheap money, conversion, and the cessation of foreign lending, were deprived of profitable investment and forced to look for new opportunities. These funds comprise not only the resources of the potential house-buyers themselves but also of capitalists who invest in real estate, and of banks who finance house purchases.[29] Third, the building industry itself may have been anxious to develop new markets. We gain the impression that during the twenties it was kept busy with government-sub-

[25] *Economist* (London), Building Societies, Special Survey, April 11, 1936.

[26] Cf. M. H. Schoenfeld, "British Housing Policy," *Monthly Labor Review*, October 1937.

[27] Clark, *op. cit.*, pp. 99–102, p. 126.

[28] Cf. A. T. K. Grant, *A Study of the Capital Market in Post-War Britain* (London, 1937), p. 244.

[29] *Ibid.*, pp. 238–239, 240–242.

sidized contracts and with work for local authorities.[30] We have seen that the former type of construction ceased entirely, and that the latter type declined substantially during the depression. The industry was certainly in need of new outlets.

It is perhaps not pure fancy to imagine that in this search for new markets the dormant demand of the middle classes was discovered — a demand which may have been present to a lesser extent even in the twenties, but to which no attention was paid at that time. Nobody could have suspected the magnitude of the boom which was the result of this discovery. It cannot be interpreted merely in terms of objective needs and shortages. To a large extent it must have been also a matter of fashion — of the Robinsons' buying a house because the Joneses had done so.

I have wandered far afield in an attempt to put British budgetary policy into its proper historical setting. It is time to summarize the conclusions. We have seen that what we ordinarily have in mind when we think of a government's balancing its budget — namely, the cutting of expenditures on ordinary services which the government provides and the increase of rates of taxation on ordinary sources of revenue — was of only minor importance in the success of British policy. The huge cut in the national debt service and the imposition of the protective tariff provided resources which were of greater importance. We have noted that resort to these opportunities did not constitute a policy which could be repeated or freely imitated by others.

But, looking beyond the narrow confines of budget accounting, we have seen that the major factor which made it possible to pursue a budget-balancing policy was the fact that national income did not fall much between 1929 and 1931, and that it ceased to fall thereafter. We found the explanation of this stability of the British system in the possibility of devaluation, the large budget, the redistributive effects of progressive taxation and social expenditures, and in the stagnation of the twenties. We noted again that all these factors were rather peculiar to Great Britain.

Realizing that the stability of Great Britain was a necessary but not a sufficient factor in making British budget policy finally successful, we glanced at the recovery of the thirties, and suggested reasons for believing that a rather discredited instrument of monetary policy, cheap money, may have had considerable

[30] *Ibid.*, pp. 244–245.

effectiveness in the special case of Great Britain. The rest of the recovery was achieved by fostering the home market, and by the favorable turn in the terms of trade. All these factors are either matters of policy which, if imitated, would prove to be ineffective, owing to the different setting in which they would have to operate, or not matters of policy at all but sheer good luck.

I suggest, therefore, that there is no British budgetary policy that can be successfully imitated, and that it is rather naïve to contrast the American and the English experience, implying that we should have done as the British did.

It would, of course, be possible to draw a different moral from the story. It is true, it might be said, that the British experience was the result of a unique set of circumstances rather than of a policy, and that this unique set of circumstances cannot be imitated by others. But is not that the very lesson to be learned? Are not all recoveries the results of nonrecurrent circumstances? Is not the lesson taught by the experience of Great Britain that it is wrong to experiment with various cyclical policies, that the best thing is to wait until the natural forces of recovery assert themselves?

Against this view I would urge three objections. In the first place, it is relatively easy to wait for recovery if one's income has fallen 15 per cent; it is much harder — perhaps impossible — to do so if one's income has fallen more than 50 per cent. Second, the interpretation is not correct that the British balanced their budget, restored confidence, and then waited for recovery to come. They had at their disposal several positive measures which proved very effective in the circumstances in which they were applied. Third, I believe that, mainly owing to the stagnation of the twenties, the natural forces of recovery, the unused investment opportunities, were particularly strong in the recent British experience. They could be relied on to a greater extent than is likely to recur in the near future to carry the country out of the depression.

THE SIGNIFICANCE OF THE GOVERNMENT TRUST FUNDS FOR MONETARY POLICY

G. Griffith Johnson, Jr.

DURING the depression and recovery years the existence of a large and partially artificial volume of excess reserves has simplified the Treasury's financing problems. At the same time, the presence of trust funds and investment accounts, greatly extended by the reserve funds of the Social Security program, has substantially moderated whatever dependence on the market remained for the Treasury. Furthermore, the management of these funds and accounts provides the Treasury with a powerful instrument for influencing the market itself.

The accumulation of trust funds has broader implications also. In this country, in contrast to Europe, the national debt has been habitually regarded as a temporary phenomenon. Upon several occasions in the nineteenth century the credit situation was disturbed by Treasury surpluses without debt available for retirement. It is ironical to recall the warnings expressed in the 1920's against too substantial a reduction of the federal debt. The Great Depression and subsequent years put an end to such worries. Between 1931 and 1938 a net deficit of twenty billion dollars was accumulated, and the sharp recession of 1937–38 has postponed the reappearance of a balanced budget. There is no immediate reason for concern over the prospects of a federal debt insufficient to provide for the quarterly tax dates and to permit ample leeway in credit control. Nevertheless, the mere occurrence of any substantial *net* retirement of debt may have disturbing repercussions. It has been frequently asserted that the tax structure as revised and enlarged during the depression, when applied to a national income comparable to that of 1929, might produce a surplus despite the higher level of ordinary government expenditures. But in view of recent events such a development does not seem probable in the near future. The large annual accumulations of government securities in the various trust funds and investment accounts appear to be of much more immediate importance, for these supply the Treasury with net additional cash from their proprietary taxes or other income.

The larger trust accounts and funds have been established in an attempt to extend the insurance reserve principles to newly inaugurated governmental activities in the regulatory and social welfare fields. It was natural that they should be invested almost exclusively in government or government-guaranteed obligations, since these are supposed to be the safest of all securities. The reserve accounts are to be built up against potential future liabilities which may require their liquidation. In some cases, moreover, reserve funds are being accumulated in order to provide a steady interest return in the future. In these latter instances, no liquidation at all is contemplated, and a continual and permanent absorption of the public debt is in process.

The trust accounts and reserve funds are very important to the Treasury and its monetary policy. Through absorbing the public debt they ease the deficit-financing of the Treasury, cash being exchanged for securities, and they will continue to do so in the case of future deficits. If the budget is balanced, they will alleviate refunding problems. In terms of monetary policy, the important fiscal factors are the *net* cash expenditures or receipts of the government, the *type* of expenditure, and the *source* of the money. With respect to net cash transactions, the appropriations to the trust accounts disguise the actual cash expenditures of the government, so that the budget is unrevealing as far as monetary policy is concerned. With regard to type of expenditure, the expenditures on the trust accounts can scarcely be considered stimulating to the economy. This is especially true when taken in conjunction with the third factor, the tax source, which in the case of the Social Security funds is pay-roll taxes. Consequently, in this connection arise all the uncertainties regarding the deflationary nature of debt retirement and the existence of over-saving, as well as important business cycle considerations.

To the extent that the Treasury actually controls the investment management of the funds, it is thereby enabled to exercise an important influence in the government security markets through the timing of investment and the shifting of issues. Moreover, the presence of large cash income from the funds may well produce a tendency toward a more lax scrutiny of federal expenditures. All these aspects of the trust accounts are necessarily interrelated. For purposes of analysis, however, it will be convenient to deal separately with certain phases of the problem. Thus the first section of the study will describe the principal re-

serve accounts. There are ten of these: the Old-Age Reserve Account, the Unemployment Trust Fund, the Railroad Retirement Account, the government employees' retirement funds, the United States Government Life Insurance Fund, the Postal Savings System, the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation, the Mutual Mortgage Insurance Fund, and the Housing Insurance Fund. Each of these will be treated in turn. Then, in the four sections which follow, the study will describe the significance of these funds for four major aspects of Treasury policy: first, the relation of the funds to the budget; second, the relation of the funds to debt retirement; third, the relation of the funds to business cycles; and fourth, the relation of the funds to the Treasury's position with respect to the security markets.

THE TRUST FUNDS

It may be well to begin with a brief description of the principal trust accounts or funds which play so large a part in Treasury financing at the present time. Some of them date from World War days, but the more important ones have resulted from New Deal legislation.

In the first place, and most importantly, there is the *Old-Age Reserve Account*, established in connection with the old-age pension program under the Social Security Act of 1935. Its assets are derived from annual Congressional appropriations (and the compounded interest thereon), which in turn are supposed to approximate the income from the pay-roll taxes on employees and employers set up in the same act (for constitutional reasons the appropriations could not be automatically adjusted to the receipts from the taxes).[1] The income is invested in United States government securities, either through open-market purchase or by special issue, but at a yield of not less than 3 per cent. The fund is supposed to provide a completely self-sustaining pension program, requiring no current or future subsidy from the Treasury. In order to accomplish this, it was believed necessary to build up

[1] The technical actuarial accounting by the Treasury for the Old-Age Reserve Account is a complicated and arbitrary arrangement. For an analysis, see Annual Report of the Secretary of the Treasury for 1937, pp. 49–54. Briefly stated, the Treasury issues 3 per cent obligations to the account in an amount approximately equal to 95 per cent of the income from Title VIII taxes, and carries the excess of Congressional appropriations over that amount as a credit to the unexpended balances of the account.

over the next forty years a reserve exceeding fifty billion dollars, so that the interest on the reserve, plus the current income, would cover the greatly increased expenditures which will be necessary as the present generation becomes eligible for pensions.

The Social Security Act also set up the *Unemployment Trust Fund* in connection with the unemployment compensation program. In this case also there was enacted a special tax, but on employers only, and credit is allowed up to 90 per cent of the tax for payments made under approved state compensation programs; the remaining 10 per cent is used for administrative expenses and for grants to states for administrative expenses. The states, however, are compelled to deposit their funds with the Treasury, to be placed in the Unemployment Trust Fund, and the income of the fund is entirely confined to their deposits, plus interest. The Treasury is charged with the investment of such funds as are not required to meet current withdrawals by the states, but the yield on the government securities purchased must not be less than the average rate of interest on the entire public debt. No withdrawals were permitted until two years of payment had elapsed, so that a reserve of some size could be built up. Thereafter, because of withdrawals in periods of unemployment, the fund was not expected to show any secular increase. At the time of its institution it was estimated that it might reach a level of from two to three billion dollars, but the recession beginning in the fall of 1937 may prevent it from developing to that amount in the near future.

Similar in character to the Old-Age Reserve Account is the *Railroad Retirement Account*, set up finally in June 1937 by the Railroad Retirement Act in connection with a pension plan for railroad employees. In this case, also, there is a special pay-roll tax, established in the Carriers' Taxing Act of June 1937, on both employers and employees, the income from which to the Treasury is supposed to be offset by annual Congressional appropriations to the Railroad Retirement Account. Likewise it is contemplated that a considerable reserve will be built up, although payments have been and will be more substantial in the earlier years, and it appears that the fund will do well to maintain its present position. The minimum yield on government securities purchased for or issued especially to the account is 3 per cent.

The government employees' retirement funds are different from the two just discussed in that the federal government makes an

annual contribution to them, and this contribution frequently exceeds the net annual increase in the funds (from current payments), so that there is no net cash gain to the Treasury.[2] In addition to the federal share, employees' contributions are deducted from their wages or salaries, and the total net income is invested by the Treasury, chiefly in special 4 per cent notes. The principal fund is the Civil Service Retirement and Disability Fund, established in 1920; the lesser ones are the Foreign Service, Canal Zone, and Alaska Railroad Retirement and Disability funds. There is also a group of smaller funds of a similar nature which the Treasury manages but to which the government does not contribute: the District of Columbia Teachers' Retirement Fund, the Longshoremen's and Harbor Workers' Compensation Fund, and the District of Columbia Workers' Compensation Fund.

The United States Government Life Insurance Fund was set up under the World War Veterans' Act of 1924, consolidating the War Risk Insurance program. In 1931 veterans were permitted to borrow from the fund against their adjusted service certificates, and the act of June 1936 which authorized the payment of all adjusted service certificates also instructed the Treasury to redeem the fund's certificate holdings by issuing to it an equivalent amount of 4½ per cent adjusted service bonds. In addition, the fund still holds a very large amount of ordinary government securities, and is at present increasing annually at a substantial rate because of the excess of premiums and interest over current payments. As the average age of veterans rises, however, this increase will tend to diminish, and eventually a sharp liquidation will take place.

The principal assets held by the *Postal Savings System* against its deposits are government securities, and among these is a special series of 2 per cent notes. While the proportion of government obligations in the investment account of the system has grown rapidly since 1933, total deposits have remained about the same, and, unless a growth similar to that of 1930–33 should again occur, the system will not provide a significant demand for additional securities in the future.

The Federal Deposit Insurance Corporation, like the old-age

[2] Technically, the federal appropriations are used to meet the current expenditures, and the employees' contributions are held in trust by the funds; but this is immaterial from the net cash standpoint of the Treasury.

pension program, is in the process of building up a substantial reserve with which to meet future liabilities due to bank failures. Its income comes from an annual assessment on insured banks, the principal portion of which is invested in government securities, including a special issue of 2 per cent notes. Through that issue the Treasury retains some control over the form of the investment, and through the annual accretion to the reserve a fairly large amount of government securities is absorbed. The *Federal Savings and Loan Insurance Corporation* operates in a similar manner, but the extent of its operations and the contemplated reserve are much smaller.

Finally, the *Mutual Mortgage Insurance Fund* and the *Housing Insurance Fund* are being accumulated by the Federal Housing Administration as reserves against its mortgage insurance activities.

In addition to these trust funds and reserves, the Treasury also manages a number of investment accounts, the total income from which is relatively small. The most important of these are the Alien Property Custodian Fund and the Individual Indian Trust Funds. It should also be noted that a considerable amount of government securities is held in the portfolios of government agencies, principally the Federal Land Banks, Intermediate Credit Banks, and Banks for Coöperatives.

THE TRUST FUNDS AND THE BUDGET

Government treasuries have traditionally a peculiar interest in balanced budgets. In times of war or depression other factors may outweigh their concern over budget unbalance, but only temporarily; after a period they tend to resume their position as champions of financial orthodoxy within the political administration. Their role in this matter does not arise primarily from their traditional background, nor even from the realization of the broader effects of continuous deficits on the general economy. Rather it springs chiefly from the simple fact that they are charged with the function of procuring the funds whereby the government is enabled to spend, and a protracted deficit keeps them at the mercy of increasingly jittery money markets. Once this basic consideration is removed, Treasury pressure for budgetary balance is likely to be greatly weakened, since it then depends upon more vague and personal factors of financial attitude and political philosophy.

TABLE 1

TOTAL GOVERNMENT SECURITY HOLDINGS, BY TYPES, FOR THE PRINCIPAL TRUST AND RESERVE FUNDS, DECEMBER 31, 1938

(millions of dollars)

	Special issues	Ordinary issues	Securities guaranteed by U. S.	Total
Old-Age Reserve Account	862	...	...	862
Unemployment Trust Fund	1064	...	.	1064
R.R. Retirement Account	76	...	. .	76
Employees' Retirement Funds	468	...	. .	468
Government Life Insurance Fund	507	272	. .	779[a]
Postal Savings System	52	905	167	1124
Federal Deposit Insurance Corp.	105	264	...	369
Federal Savings & Loan Insurance Company	...	11	104	115
Mutual Mortgage & Housing Insurance Fund	...	20	...	20
Others	22	89	. .	111
Total	3156	1561	271	4988
Other Government Agencies	...	307	41	348[b]

[a] Also holds 42 million dollars of Federal Farm Loan Bonds.
[b] Also 870 million dollars of Federal Farm Loan Bonds and Intermediate Credit Bank Debentures.

Source: Treasury Department Press Release.

The trust funds in the federal government operate in this direction. They do not, as many people seem to believe in the case of the Social Security funds, help the Treasury to balance the budget, but they do aid the Treasury in meeting the cash requirements of an unbalanced budget. This is particularly true of the Old-Age Reserve Account and the Railroad Retirement Account. The transactions in connection with these two accounts have little effect on the *budget*, except to inflate the expenditure and receipt figures by approximately equivalent amounts. The Treasury receives the income from the pay-roll taxes on employees and employers, and in return issues special obligations to, or purchases market obligations for, the accounts.

The important consideration, however, is that, while the Treasury receives its income in cash, it pays the appropriations to the accounts in government securities; the public debt is increased, and the Treasury has cash wherewith to meet other demands without resorting to the market. Now it is true that the Treasury

could use the tax money to purchase securities on the open market, either directly for the accounts (if a 3 per cent yield were available) or to offset the issuance of special securities to the accounts, and in periods of budgetary balance this would undoubtedly be done; but as long as there is a deficit it is much simpler and more sensible to issue securities directly to the accounts and to use the cash in meeting the deficit. Thus these accounts remove the pressure on the Treasury which would otherwise result from resorting to the market for an equivalent amount of funds.

The Old-Age Reserve and Railroad Retirement accounts are of peculiar importance in this connection because they affect *both* sides of the ledger. They increase the net cash resources of the Treasury, but do so only at the expense of increasing the budgetary deficit, since the appropriations to the accounts must produce an equal decrease in the total debt privately held if the budget is to be balanced. The other trust funds operate for the most part *either* to increase the cash resources without affecting the deficit *or* to provide a budgetary expenditure which does not have to be met in cash.

In the latter group fall the government employees' retirement funds. The federal government contributes a share annually to these funds, but these appropriations need not be met in cash. They may take the form of special issues of government obligations, thus increasing the public debt but avoiding a resort to the market to fulfill the statutory and budgetary requirements. To the extent that current payments out of the funds exceed the current contributions of the employees, however, either the federal contribution must be made partially in cash or else a portion of the existing security holdings must be liquidated. Conversely, if the employee contributions exceed the current outgo, the Treasury has available that much cash for investment in government obligations. In recent years the former situation has existed to a small extent.

The other trust funds tend to supply cash for the Treasury without affecting the budgetary situation; in other words, they supply a current and continuous demand for government obligations unaffected by market psychology or movements in interest rates. The Unemployment Trust Fund has up to now been the most important source of demand, and it will doubtless continue to be so except during periods when the states are in a position to make net withdrawals. The Federal Deposit Insurance Corpora-

tion and the Government Life Insurance Fund also are important, and the former may very well continue to be so indefinitely. The Postal Savings System, however, since 1933 has given no indications of further expansion.[3] All these funds or reserves acquire their income from special sources outside the ordinary tax receipts of the federal government. Included in this group also are the numerous minor trust funds managed by the Treasury.

The importance of the trust funds in establishing a gap between actual net cash expenditures and the formal budgetary deficit is shown by Tables 2 and 3, which compare, for the fiscal years 1937 and 1938, the budgetary excess of expenditures (excluding debt retirement) with the net cash expenditures or receipts.[4] Table 2 gives the net non-cash expenditures included in the budget — that is, expenditures in excess of actual cash disbursements — for the old-age and retirement funds:

TABLE 2

NET NON-CASH TRUST FUND EXPENDITURES OF THE BUDGET

(millions of dollars)

	Old-Age Reserve Account	R.R. Retirement Account	Employees' Retirement Funds	Total
Fiscal Year 1937	265	..	36	301
Fiscal Year 1938	387	67	73	527

In addition to these non-cash expenditures, the Treasury received cash from the Unemployment Trust Fund through the issuance of special obligations, and other trust accounts and agencies increased their holdings of Treasury obligations by a substantial amount. While the purchases of ordinary obligations by trust accounts do not *directly* increase Treasury cash if they are purchased in the open market, nevertheless the financing position of the Treasury is thereby strengthened, and the privately held debt is decreased.

The net cash gain or loss of the Treasury, after taking into consideration the operations of the trust funds and accounts, is indicated by comparison in Table 3 of the total budgetary excess of expenditures (less debt retirement) with the non-cash expenditures, cash receipts from the Unemployment Trust Fund, and increased holdings of ordinary obligations by the other trust ac-

[3] See L. Sissman, "The Development of the Postal Savings System," *Journal of the American Statistical Association*, December 1936, pp. 708ff.

[4] Figures for these tables obtained from Treasury daily statements and other releases.

counts. It should be noted that the receipts from the old-age and carriers' taxes are included in revenues before calculating the net deficit.

TABLE 3

CASH POSITION OF TREASURY

(millions of dollars)

Fiscal year	Budget: excess of expenditures [a] (1)	Budget: non-cash expenditures [b] (2)	Unemployment Trust Fund net receipts (3)	Other Trust accounts: Increase in Treasury obligations (4)	Total Trust Fund accretion [c] (2+3+4) (5)	Resulting net cash outgo of Federal Government [d] (1–5) (9)
1937	3152	301	293	167	761	2391
1938	1377	527	560	63	1150	227

[a] According to revised classification adopted July 1, 1938; less debt retirement.
[b] Old Age Reserve Account, R.R. Retirement Account, and Employees' Retirement Funds.
[c] Government agencies also increased their holdings of Government obligations by 27 million dollars in 1937 and 76 million dollars in 1938.
[d] This is not identical with "net excess of cash outgo" as given in Treasury *Bulletins*, due to exclusion above of certain non-trust fund items and different treatment of miscellaneous trust accounts.

It appears that, as a result of trust account expenditures and investments, the cash deficit for the Treasury was reduced some seven hundred and sixty millions below the formal deficit in the fiscal year 1937, and eleven hundred and fifty millions below in 1938. In view of this situation, one may justifiably wonder whether in the future a greater indifference regarding the formal balancing of the budget will not be encouraged. Perhaps some evidence of this appeared in the President's budget message of January 1938, in which he called attention to the fact that under his tentative estimates the trust fund revenues would obviate any new financing by the Treasury during the fiscal year 1939, despite an estimated deficit of nine hundred and fifty million dollars — with the inference, perhaps, that this was a partial substitute for a balanced budget.

On the other hand, the nature of the budget is itself altered by the inclusion of non-cash expenditures and the exclusion of certain cash receipts, so that it no longer possesses the same economic implications or induces the same traditional political reactions. In periods when the pressure for government spending is great, the budget tends to receive little political consideration anyway.

The effect of the current appropriations to and accumulation of the trust funds will certainly be to weaken further the significance of the budget in the popular mind, as it has already been weakened in the regard of trained observers. "Balancing the budget" is one thing when it means equating current income and outgo, but the phrase loses much of its force when the budget includes expenditures for the benefit of future generations.

This situation endangers the successful working-out of the insurance reserve theory with respect to the retirement funds.[5] That theory, which attempts to establish a method whereby present workers can provide now for the increasing burden of their pensions in future years, requires for its fulfillment a genuine reductions in the public debt outstanding in private hands, or at least a reduction in the increase of such debt. If, however, the present payments stimulate, through their possible deflationary effects, the incurring of a greater deficit than would otherwise have been the case, or if they substantially weaken the pressure for a balanced budget, the purpose of their exaction is violated.

The most important budgetary aspect, however, of the effect of the trust funds on monetary policy is the gap which they create between the ordinary political connotations of the budget and the actual economic results of government finance, a gap which is a corollary to the difference between the budgetary accounting and the net cash disbursements or receipts. Since the early years of the last depression the central relationship between government fiscal policy, industrial activity, and the national income has been increasingly recognized, and fiscal policy is being fashioned into an instrument for business cycle control. As far as the *quantitative* analysis of public spending is concerned, it is the net cash item which is the important guide in formulating the policy along such lines. Nevertheless, so long as the formal budget does not approximately agree with the net cash item, any administration which would attempt to formulate and justify publicly its fiscal policy in terms of the latter, to the disregard of the budget, would risk serious political criticism on grounds of deception of the people and sabotage of the Social Security program.

The experience of 1937 is illustrative of this conflict. The administration was under pressure from within and without to balance the budget after seven consecutive years of large deficits.

[5] See M. A. Linton, "Old-Age Security: Reserve Funds and Their Relation to the Government Debt," *Annalist*, February 4, 1938, pp. 197, 220.

Even many of those who regarded deficit spending as a consciously compensatory mechanism believed that a sufficient degree of momentum had been achieved for the recovery movement to progress without the incurring of further deficits. The distinction between budgetary balance and net spending, however, was not clearly realized, nor were the deflationary effects of a sudden contraction of *net* spending. Partly as a result of the bonus payments, but partly also as a result of rapidly rising revenues from ordinary sources and from the trust funds, net government spending fell off very sharply after the end of 1936. During the nine months from July 1937 to March 1938, thanks largely to the trust funds, the government actually expended nearly three hundred million dollars less cash than it received, thereby exerting a deflationary influence of possibly substantial proportions. The roots of the present recession may well spring in part from the government fiscal policy, the too-rapid balancing of cash income and outgo.

Thus during the latter half of 1937 the country endured all the unfortunate consequences of a balanced *cash* budget while still suffering under the psychological handicap of an unbalanced formal budget, and the administration bore all the opprobrium attached to a continuing large deficit while gaining none of the political and economic benefits resulting from deficit spending. Whenever net cash spending is resumed in the future, the formal deficit thereby involved will be all out of proportion to the political advantages accruing to the incumbent administration. On the other hand, if continued progress is made toward a balanced budget the deflationary effects of the trust funds may well prove disastrous. In addition to these consequences, the accumulation of the reserve funds is likely to induce powerful agitation for increasing benefits or reducing contributions. The present position of the large trust funds, particularly that of the Old-Age Reserve Account, therefore, seems politically untenable.

THE TRUST FUNDS AND DEBT RETIREMENT

One of the most difficult problems in the establishment of social insurance centers upon the relative desirability of reserve funds as against current-cost financing (often entitled the "pay-as-you-go" plan). Whereas in Europe the full reserve system has generally been abandoned in favor of a moderate-sized contingency

reserve or a current-cost basis, in both cases plus direct government subsidy,[6] in this country the reserve fund plan as yet holds the stage. The Government Life Insurance Fund and the government employees' retirement funds were set up with accumulating reserve funds in the manner of private companies; the Federal Deposit Insurance Corporation and the Federal Savings and Loan Insurance Corporation were required to build up substantial reserves against possible future losses. With the passage of the Social Security Act, establishing the Old-Age Reserve Account and the Unemployment Trust Fund, the federal government went in heavily for the creation of reserves.

The relative merits or demerits of the reserve fund idea are matters outside the scope of this article. Suffice it to say that the adoption of such plans in this country represented an apparently logical extension of private practices into the public sphere. It was "natural that some actuaries, trained as they are to think in terms of private insurance, should cling to the idea that social insurance should be based as closely as possible on true insurance principles with interest-bearing reserves." [7] Moreover, a strong equitable argument can be made for the building up of large reserves in the case of the old-age and retirement programs, which are creating large future liabilities in favor of the present working population.[8] The theory is that the accumulation in the reserve funds of public debt which would otherwise be outstanding in private hands simplifies the transfer problem and lessens the interest burden for future generations; the interest which would otherwise be paid to the private bondholder is paid to the funds, and this interest relieves future workers of the greatly increased tax burden which would otherwise be required to meet the accruing liabilities to currently retiring workers. Serious doubts have been raised, however, regarding the actuarial and economic validity of this idea.[9]

[6] M. G. Schneider, *More Security for Old Age* (New York, 1937), p. 59.

[7] *Ibid.*, p. 54.

[8] See A. W. Wilcox, "In Defense of the Old-Age Reserve Account," *Annalist*, August 17–24–31, 1938; and Tax Policy League Symposium, *How Shall Business be Taxed*, article by E. E. Witte, pp. 160ff., for defense of the reserve idea.

[9] J. D. Brown, "The Old Age Reserve Account," *Quarterly Journal of Economics*, August 1937, p. 716; M. A. Linton, "Reserve Provisions of Federal Old Age Security Programs," *Transactions of the American Actuarial Society*, October 1935, p. 363; and written discussion of the latter article, *ibid.*, May 1936, pp. 141ff. For a review of actuarial opinion on the subject see R. A. Hohaus, "Reserve for National Old Age Pensions," *ibid.*, October 1936, p. 330.

The most important reserve fund is that envisioned for the old-age security program. In June 1934 the President appointed a Committee on Economic Security to investigate various plans for old-age pensions and unemployment compensation and to report to Congress the following January. This Committee recommended the establishment of an old-age reserve fund which should gradually increase to $15,267,000 around 1965 and thereafter level off at that figure. However, this plan would have necessitated federal contributions beginning in 1965 and running over a billion dollars by 1975. Some two weeks after the hearings had started on the Economic Security bill as outlined by the Committee's recommendations, the Secretary of the Treasury suggested a drastic change in the financing of the program in order to make it "self-sustaining"; lower benefits, higher rates, and a reserve fund which would accumulate to over fifty billion dollars by 1980 but which would require no federal contributions.[10] These suggestions were incorporated into the bill as finally passed.

Secondary only to the Old-Age Reserve Account in importance is the Unemployment Trust Fund. It is not contemplated that this reserve will accumulate indefinitely but only that it will accumulate in periods of light unemployment in order to have assets to meet the demands of periods with heavy unemployment. It is impossible, therefore, to prophesy the future development of the fund with any accuracy. At the time the act was under discussion it was estimated that a similar program initiated in 1922 would have created a reserve fund of two to three billion dollars by 1929, in addition to meeting current demands. Actually, at the end of 1938 the fund held $1,064,000,000 of government obligations. Although the effects of the 1937–38 recession were slow in appearing, since few states were eligible to withdraw funds immediately,

[10] With respect to this Treasury maneuver, Prof. J. D. Brown, a consultant of the Committee, observed: "The reason that lay behind the suggestions was that Secretary Morgenthau wanted to see the plan 'self-sufficient.' He wanted to arrange the income and disbursements under the plan so that the Federal Government would never have to subsidize the reserve for old-age insurance. In accepting his suggestions the House Ways and Means Committee altered very seriously the fine balance that the Committee (on Economic Security) thought it had established in making the reserves adequate to meet drains in times of depression, and yet as small as possible. A small reserve is essential to avoid fiscal problems and to reduce the amount of funds going into the reserve at the expense of consumer purchasing power" (*Proceedings of the American Academy of Political Science*, June 1935, p. 10); see also review of developments in O. O. Richter and W. R. Williamson, "The Social Security Act of 1935 and the Work of the Committee on Economic Security," *Transactions of the American Actuarial Society*, October 1935, pp. 372–374.

an actual reduction in the fund might occur, if unemployment should continue to be high or should increase; the probable extent of this reduction is complicated, however, by the elapsing of benefit periods.

The Railroad Retirement Account and the Government Employees' Retirement Funds are accumulating reserves in the manner of the Old-Age Reserve Account but in much smaller volume. Indeed, under present financial arrangements it is problematical whether the former will succeed in remaining solvent for many years. The latter may be expected to increase annually for some time, although its actuarial status is not entirely satisfactory, owing to deficiencies in government contributions before and during the depression. The Government Life Insurance Fund has also been increasing since 1922 at about sixty million dollars a year, but at some time in the future the process of liquidation must be expected to begin and proceed with rapidity.

The future development of the Federal Deposit Insurance Corporation reserves is, as in the case of the Unemployment Trust Fund, more difficult to anticipate than with the retirement funds, since they are being built up against unpredictable future liabilities. However, by assuming a rough average annual increase of thirty to forty million dollars, the reserve in 1945 will aggregate around six hundred millions. The Federal Savings and Loan Insurance Corporation reserve will be much smaller, probably amounting in 1945 to less than a hundred and thirty million dollars (a hundred million of which is capital in the form of HOLC bonds), depending on the extent of losses, the increase in the number and size of insured institutions, and the continuance of the present assessment rate.

In summary, it can be stated that the trust funds, exclusive of the Old-Age Reserve Account, are not likely to make any substantial dent in the volume of government debt outstanding in the hands of the public. There has been some anxiety expressed in certain quarters over a possible complete absorption of the debt by the trust funds and even a possible shortage of debt for their purposes. Such worries are entirely unrealistic, since at the present time there seems to be no indication of ending deficits and, more especially, there is every likelihood that the statutory framework of the Old-Age Reserve Account will be drastically altered before many years elapse. That does not mean, however, that there may not be important collateral effects from the ac-

cumulation of reserves. The monetary aspects center around the general problem of debt retirement and the direction of funds into saving and consumption.

It has been traditionally taught and believed in this country that public debts ought to be of only temporary duration. As one authority expressed it some twenty years ago:

> A study of the conditions and limitations under which public borrowing is alone admissible naturally leads to the conclusion that the maintenance of permanent debt ought to be avoided. If loans should be contracted only under great pressure, and to prevent the exhaustion of the agency of taxation, and if, while they exist, they act as a drag on the financial power of the State, it cannot be disputed that their speedy redemption must be eminently desirable.[11]

The Colwyn Committee in Great Britain agreed that a steady reduction of the British debt was desirable in order to maintain and improve the national credit with a view to conversion operations, to prepare for future emergency borrowing, and to avoid the risk of a falling price level.[12] Furthermore, aside from credit risks and transfer burdens, the presence of a large public debt may be disturbing to the money markets because of its implications of Treasury interference. Although admitting that a certain volume of debt is desirable to avoid disturbances from current Treasury operations and to provide machinery for credit control, certain writers have expressed the opinion that only "when debt reduction has been carried far enough to weaken the motives which have long compelled the Treasury to regard low interest rates as desirable *per se*, but not far enough to impair the effectiveness of the special depositary system," will there be "reasonable hope that the Treasury may be permanently eliminated as a direct influence in the money market," a situation which "would be a desirable novelty in American finance." [13]

From this point of view, the projected absorption of the national debt by the trust funds can only be considered commendable. While the debt is not thereby reduced, but merely *transferred* from private to public hands (the interest burden remains), never-

[11] C. F. Bastable, *Public Finance* (1917), p. 698.

[12] *Report*, p. 329.

[13] B. H. Beckhart, J. G. Smith, and W. A. Brown, *The New York Money Market* (New York, 1932), p. 405.

theless as far as the money market and government credit are concerned the effects are much the same. In the existing economic structure, however, the retirement of publicly held debt is not always as clearly desirable as it perhaps was in the years when the tradition evolved. Its repercussions now are likely to be of much greater extent than in periods when the debt transactions were a smaller percentage of community income and when the economy was not so delicately attuned to a large volume of investment, which in turn appears to be closely geared to consumption and without the stimulus of a rapidly expanding population. A present-day analysis of the desirability of debt retirement should be closely linked with business cycle considerations and should center upon the sources and incidence of taxation, the types of debt holders, and the timing of retirement.[14] Such factors as the government debt and the unhindered working of the money market are of minor significance compared with the stimulation or depression of business activity and the national income.

It may be that continued budgetary deficits will prevent any net reduction through the trust accounts of public debt outstanding in private hands. In that case the transfer of securities to the trust accounts will merely have the effect, described in the previous section, of creating a gap between the actual and budgetary expenditures. It seems probable, however, that the reduction in the volume of Treasury obligations outstanding in private hands, which began in the summer of 1937, will be resumed at some time in the future. It is of minor importance that the slow growth of the funds, plus future statutory changes, will prevent, despite possible Treasury surpluses, a complete extinction of the privately owned debt. The significant fact is the presence of *any* substantial net reduction.

The direction and degree of the monetary effects of debt retirement may be said to depend largely on four factors: the relation of the debt to the credit base, the source of the tax funds, who holds the debt, and at what part of the business cycle the retirement occurs.[15] When the reduction of the outstanding privately held debt which may result from the accumulations of the reserve funds is considered in the light of the four factors just men-

[14] "Debt retirement" throughout this paper is used as synonymous with "reduction in privately held debt."

[15] See discussion in W. Withers, *The Retirement of National Debts* (New York, 1932), pp. 132ff., especially pp. 163ff.

tioned, the possible monetary effects are clearly of first-rank importance.

With respect to the first factor, the relation of the debt to the credit base, there is no effect peculiar to the reduction of debt through the trust funds. Deflationary tendencies would result from debt retirement to the extent that the withdrawn debt was used as the basis for central bank credit.[16] That portion of the debt which in the past has served as collateral for bank notes has largely been retired, but government obligations are at present eligible as security for Federal Reserve notes and as collateral for member-bank borrowing at the Reserve Banks. However, almost complete extinction of the debt would be necessary before any restrictive influences would appear along these lines, and ample substitutes could be made available in that event.[17]

The second factor, that of the tax source, lies at the root of the actual and potential deflationary effects of the trust funds. The significant funds in this regard are the Social Security funds, which are quantitatively also the most important.[18] Their revenues come from pay-roll taxes on employees and employers. The employee taxes are clearly equivalent to forced savings and to an almost net reduction in consumption expenditures. The incidence of the pay-roll taxes on employers has been the subject of much discussion, but it seems generally agreed that the taxes will in general be shifted onto either the workers or the consumers, so that the effect again will be forcibly to increase saving and to reduce current consumption.

At this point the third factor, the holders of the debt, enters the picture. They are principally banks, other institutional investors, and wealthy individuals. When the government uses the Social Security funds to retire outstanding debt, or in deficit periods to replace additional debt issues, the former debt-holders (or those who would have purchased the additional securities) are sup-

[16] Withers, *op. cit.*, p. 167. He holds that the reduction of debt in the United States during the 1920's was not deflationary, but that in France and England it probably was because it resulted in a reduction of bank advances.

[17] See Beckhart, Smith, and Brown, *op. cit.*, p. 409.

[18] The income to the retirement funds is derived from percentage deductions on the pay rolls of government employees and from federal contributions, but the former are offset by payments out of the funds. The premium paid to the Government Life Insurance Fund would probably be saved in large part anyway. The reserves of the FDIC and the Savings and Loan Insurance Corporation are built up from assessments on the insured institutions, so that the net effect is relatively unimportant.

plied with cash which, except for the taxes, would have been used for consumption expenditures, but which they will presumably attempt to invest in replacement of the government bonds. Consequently, there is a net reduction in the community's current consumption expenditures and an increase in aggregate savings. Now, if the funds which the debt-holders receive result in genuinely new investment, this effect of the Social Security program may be considered desirable as increasing the real wealth and productivity of the community. The danger is that that result will not follow. The banks whose holdings are reduced may already have excess lending power, so that the debt retirement leads to a contraction of deposits; or the funds may finally come to rest as idle bank balances; or they may augment the resources of the capital and call loan markets without eventually being used in real new investment. Many writers take the attitude that the reduction of debt will stimulate capital investment as well as reduce consumption, but it seems more likely to depress investment through contracting consumption than to stimulate it by lowering the rate of interest — it is likely to lower primarily the *wrong* rates of interest, those on gilt-edged investments. Thus the final result may be very deflationary. The purchasing power expended on consumption goods may be decreased while that spent on investment goods is not correspondingly increased. Under anything like present conditions in the capital markets, any public debt retirement would probably lead to a contraction of deposits or an increase in idle balances, even if the funds were acquired exclusively from the upper income brackets so that consumption would be unaffected. When the retirement is effected through taxes reducing consumption expenditures, a double-edged contraction is accomplished. Similarly, in deficit periods the stimulating effect of the budgetary deficit is reduced.

The fourth factor, the stage of the business cycle in which retirement takes place, largely determines what use will be made of the liquid funds supplied the former debt-holders. In depressed periods when the demand for investment is inactive, the additional funds supplied the capital market are likely to remain idle. At the same time, the reduction in consumer purchasing power will further contract whatever current investment is closely geared to consumer demand. But in periods when investment demand is active and not closely related to current consumer demand, and when reasonably full utilization is being made of existing supplies

of capital, the funds supplied by the trust accounts are likely to result in a stimulation of capital investment and stock market speculation. In other words, they may facilitate the generation of a boom. In all phases of the cycle, the downward pressure on interest rates is greater than it would otherwise be, aggregate savings are greater, and aggregate consumption is less. The problem is, what is the consequent effect on new capital investment?

The traditional analysis of the position of thrift in the economic system proceeds from the premise that the more capitalistic the structure of production, the greater is the efficiency of labor and the eventual return to society. It is thus assumed that the only sound and lasting means of transition from a less to a more capitalistic structure is by an increase in genuine saving. On the further assumption that supply creates its own demand, the only readjustment made necessary by increased saving is that between the price of production and of consumption goods. Under this analysis the Social Security taxes should stimulate the accumulation of capital goods, and thus the national income, by forcibly increasing saving.

In recent years, however, empirical observations and theoretical analysis have come to stress the *demand* function for capital investment, and in many cases to lean toward the view that in our present stage of capitalistic development a secular condition of almost chronic "over-saving" or "under-investment" persists. Certainly with respect to the depression years and to the subsequent recovery it can with reason be asserted that the volume of new investment has borne little relation to the volume of available investment funds, but has been primarily adjusted to the rate of increase of consumer demand. Under such conditions (and no change in them is foreseeable in the future) the present financing of the Social Security program can only be considered as injurious to the progress and maintenance of economic recovery. "It is difficult enough to cope with recessionary tendencies in any case without inviting additional trouble; and there is no escape from the conclusion that the impounding of these funds adds strength to the deflationary forces." [19]

Before concluding this section a reference should perhaps be made to the effect of the trust accounts on the types and maturities of issues offered by the Treasury. It may well be, as most

[19] A. H. Hansen, *Full Recovery or Stagnation* (New York, 1938), p. 283.

people appear to believe, that the projected accumulation of the trust accounts will be prevented through statutory or other changes. In managing the public debt, however, the Treasury is naturally not free to operate on that assumption. In determining its financing policies the Treasury must give ample consideration to the estimated future absorption of the debt into the funds as they now are set up. Thus the Treasury feels under obligation to provide in each year of the immediate future sufficient maturing or callable securities to take care of the demands of the trust accounts. Otherwise, it might be embarrassed by a situation in which it was forced to provide investments for the accounts at their minimum yields, and yet such yields were not available in market purchases. Moreover, if in the future the "other half" of the compensatory mechanism of deficit financing should work, and a substantial surplus for debt retirement appear, the Treasury might be forced to retain idle funds or pay premiums for debt retirement (as was done in the 1880's). To avoid such contingencies, the Treasury in the past six years has conducted its financing operations so that a substantial volume of obligations matures or is callable in each of the next twenty-six years.

This necessity of providing for projected future requirements of the trust accounts means that the Treasury is unable to manage the public debt solely according to the criteria of traditional orthodox principles. It is unable to take advantage of favorable markets to fund as much of the debt as possible into long-term bonds, but rather must keep a substantial portion in the form of short- and medium-term obligations, with the consequent presence of continual refunding problems and the multiplication of complex issues. The British, on the other hand, follow the practice of funding as much as possible of their debt into practically permanent bonds with either no maturity date or a far distant one, thus substantially reducing their refunding problems, while at the same time suffering little loss on the coupon rates.

This pressure on the Treasury to maintain a substantial amount of short- and medium-term debt, however, is perhaps not unfortunate in view of the conflict between orthodox financing principles and a healthy condition of the government bond market. That market is at present the most sensitive money market, because of the huge holdings of government bonds by banks. Any substantial recovery in bank loans is likely, as in 1936–37, to lead to a liquidation of bank holdings of government bonds, which

in turn may depress bond prices, weaken the capital structure of banks, and in general tend to undermine the recovery movement.[20] Only if the banks hold government obligations of near maturity can these influences be avoided and a rise in interest rates easily absorbed. The Treasury, on the other hand, has been unwilling to issue large volumes of short-term obligations (except in the early recovery years, when it was necessary), since they raise continuous refunding problems and place it permanently at the mercy of the markets. To the extent, therefore, that the possible potential requirements of the trust funds have induced the Treasury to shorten the maturity of new bond issues, the effect on the public debt has been in the right direction.

INVESTMENT POLICY AND THE BUSINESS CYCLE

One important monetary aspect of the trust funds which should be noted lies in the possibilities for influencing the course of the business cycle presented by the management of their investment. If in the future it should become desirable to restrain a boom in the investment markets, the accumulation of the trust funds places the Treasury in a strong controlling position. Instead of using the income from the funds to withdraw outstanding debt from private hands, it can issue special securities to the funds and retain the cash on deposit with commercial banks, thus preventing a stimulus to the capital market while exercising a contractive effect on consumption.[21] Moreover, the Treasury can exert a still stronger restraining influence by transferring the deposits to the Reserve Banks, thereby reducing member-bank reserves. If the occasion for deficit financing subsequently arose, the Treasury would then have on hand available cash resources which would lessen its dependence on the money markets (which are frequently unfavorable in the early stages of a depression).

While the Treasury can always build up its balance with commercial banks or with the Reserve Banks by issuing public debt obligations, nevertheless the situation is somewhat different with respect to the income of the trust funds, since that income requires no special effort on the part of the Treasury. It accrues regard-

[20] See Hansen, *op. cit.*, p. 272.

[21] It should be noted that at present all Treasury deposits with commercial banks, except for minor balances of disbursing officers, are in the special depository banks, and that the only method whereby these deposits are created is for banks to purchase new issues of Treasury obligations and then to be allowed the privilege of retaining such subscriptions in the Special War Loan Accounts.

less of the budgetary or public debt position, and must be invested in some form. Presumably, the Treasury will ordinarily continue to invest it as it accrues in federal obligations, either in the open market or in special issues (the income from which would be used to retire, or in place of, ordinary obligations), thereby having no direct and prolonged effect on member-bank reserves or deposits. But the ability to postpone investment carries important implications for the instrumentation of monetary policy in boom times, and, should it ever be used, would greatly complicate the relationship of the Treasury to the Federal Reserve System.[22]

With respect to the business-cycle aspects of the trust accounts, the Unemployment Trust Fund is in a peculiar position. Its reserves are accumulated in times of relative prosperity for the specific purpose of being utilized when unemployment increases, and thus in certain stages of a depression it might be necessary to liquidate its holdings of government obligations, to some extent at least. In this connection Professor Hansen has pointed out the importance of the centralization of investment powers in the hands of the Treasury. If each state invested its own funds, the alternate accumulation and liquidation of securities might have a very aggravating effect on the business cycle, whereas the federal Treasury is in a position to utilize the reserves in a compensatory manner.[23] The Treasury can use the cash income to stimulate recovery and to dampen a boom in the same manner as with the reserves of the other trust accounts. It is with the onset of depression, however, that the peculiar significance of the Unemployment Trust Fund appears. Then the importance of the fund arises mainly from the ability of the Treasury to issue special obligations to the fund in preference to purchasing ordinary obligations in the open market.

The presence of special issues in the portfolio of the fund obviates the necessity of extensive liquidation in the open market and shifts the burden of supplying the necessary cash onto the shoulders of the Treasury. Consequently, it leads to net cash borrowing from the money market, *without any increase in the*

[22] For a full discussion of the various possible forms of investment and their monetary implications, see Hansen, *op. cit.*, Chap. VIII.

[23] Senate Hearings on S. 1130, 74th Cong., 1st sess. (1935), pp. 454ff.; House Hearings on H. R. 4120, 74th Cong., 1st sess. (1935), pp. 372ff. See also J. F. Dewhurst, "Economic Implications of the Social Security Program," *Social Security* (1936), p. 13; Paul Douglas, *Social Security in the United States* (New York, 1936), p. 143.

public debt or in the formal budgetary expenditures. The economy receives the stimulating effect of net deficit spending without the psychological handicap of an apparent deficit or an increase in the public debt. In contrast, the dumping of existing issues on the market might have a demoralizing effect which would efface the stimulus of the compensation payments. The repercussions of new issues by the Treasury and of extensive sales depressing the price of existing issues are quite different.

The presence of special securities is not necessary to avoid a market liquidation of the fund's portfolio, since the Treasury can itself purchase ordinary government securities directly from the fund or can sell them to the Federal Reserve System. But the special-issue procedure is the most expedient, and up to the present the investments of the fund are exclusively in special 2½ per cent certificates.

In accordance with the theory that public investment should be planned, in so far as possible, to occur in times of depression, Professor Robbins has suggested that reserves should be built up ahead of time in order that the blow to confidence resulting from an unbalanced budget might be avoided. Furthermore, since the accumulation, if invested, would intensify instability by keeping interest rates down in the boom, and the liquidation would further depress the market and keep rates up in the slump, he suggests that the reserves should not be invested but should be hoarded, thereby having the converse effect.[24] However, it is highly doubtful that a rigid policy of sterilization is desirable. If such a policy were attempted too early, the recovery movement might be halted or boom prosperity might be prematurely cut off. Indeed, it seems likely that any approximation of prosperity will require all the consuming power which the community can muster plus considerable government intervention. Under such conditions the sterilization of purchasing power by the government is a dangerous instrument. Furthermore, as we have seen above, the mechanism of the Unemployment Trust Fund obviates the need for an unbalanced formal budget (to finance unemployment compensation) so long as the fund remains solvent.

Nevertheless, the trust funds inevitably do invest the Treasury with extensive powers of monetary control. Either by leaving the funds on deposit with the Reserve Banks, or with the member

[24] "How to Mitigate the Next Slump," *Lloyds Bank Limited Monthly Review*, May 1937. Presumably he means an unbalanced cash budget.

banks, or by investing them in securities purchased in the open market (either directly or indirectly), the Treasury can influence the credit cycle in precisely the same manner as the Reserve System through its open-market operations.[25] In addition, through the automatic process of net withdrawal by state governments from the Unemployment Trust Fund, the federal Treasury is enabled to increase the cash income of the community in periods of large unemployment without affecting the current budget or increasing the national debt. It may be thoroughly undesirable that monetary powers should be divided between two authorities in this way, but the fiscal and other activities of the federal government, together with Congressional legislation, have such extensive monetary ramifications that complete centralization of monetary control in one agency is not possible.[26] However reserve funds are managed, they are going to have significant monetary effects, and it is important that these effects be consciously coördinated with general policy. To that end it is "necessary to leave the utmost flexibility in the hands of the currency authorities." [27]

With respect to the broad monetary implications of the Unemployment Trust Fund, it has generally been considered that unemployment insurance is automatically contributory to a reduction in cyclical fluctuations. Unemployment insurance contracts consumption in prosperous years and expands it in depression years, thereby tending to produce a less uneven flow of consumer purchasing power. But before we place too much confidence in this aspect of unemployment compensation, several detractive factors must be considered. In the first place, the benefits are small in comparison with wages, so that a substantial contraction of consumption will occur anyway. Second, the benefit periods are short, so that the program will not carry any one individual through a normal depression. Finally, the timing of the unemployment compensation program, combined with its automatic

[25] The Treasury, however, is hampered in two respects: it is costly for it to sterilize funds, and its freedom of action is greatly circumscribed in periods of depression by the necessity of selling securities (E. M. Burns, "Financial Aspects of the Social Security Act," *American Economic Review*, March 1936, p. 21; see also A. H. Hansen, "Monetary Policy in the Upswing," *Lessons of Monetary Experience*, ed. Gayer, pp. 89ff.).

[26] "The case for the unified direction of both these agencies (the Treasury and the Reserve System) is strengthened" by the need for coöperation and harmony in managing the trust funds (Douglas, *op. cit.*, p. 212).

[27] A. H. Hansen, testimony in House *Hearings*, p. 372.

operation, makes it a clumsy and ineffective instrument for mitigating substantial cyclical swings.

The relief afforded by the program from the point of view of the total volume of consumption is, on the one hand, subject to considerable delay in its appearance and, on the other, short-lived. It may be many months after the downturn begins before a net liquidation of the fund occurs, depending upon the rapidity with which unemployment develops and the lengths of the required waiting periods. This time-lag is an extremely serious one, since it permits deflationary influences to gather momentum, a process which is spurred on by the continuing excess of the pay-roll taxes over benefit payments. Such an excess will ordinarily continue for a substantial interval even in periods of severe depression and large unemployment. Eventually the liquidation process will start and the net disbursements will help to maintain consumption expenditures, but that factor in turn is short-lived because of the limitations on benefit periods or on the resources of the fund. The majority of workers continue in employment even in depression, and the pay-roll tax on their wages continues to be collected. The bulk of the unemployed will use up their benefit rights within a relatively short interval, and, as that occurs, the receipts from the pay-roll tax will again tend to exceed benefit payments, although the depression and large unemployment may still exist.

The inability of the Unemployment Trust Fund to cope with more than brief periods of unemployment has frequently been recognized and officially admitted. But the corollary thereto has not always been realized, namely, that because it is built up from consumption-reducing taxes the program helps to maintain consumption expenditures only in a very limited period beginning a substantial interval after the onset of the depression, and that the remainder of the time the net excess of pay-roll tax receipts lends support to any existing deflationary forces. Of course, the degree to which the program has this effect depends upon the level of the pay-roll tax. Were the pay-roll tax maintained at a low level, the deflationary influences would be substantially mitigated; but this in turn would endanger the Fund's solvency.

The operation of the Unemployment Trust Fund in the recession of 1937–38 is not an adequate illustration, since up to January 1938 no states except Wisconsin were eligible to make benefit payments. Beginning with January, however, twenty-three states were in a position to pay benefits, and we find that in the follow-

ing seven months — from January through July 1938 — they paid two hundred and thirteen million dollars. During the same period they collected two hundred and forty-two millions, so that in the worst phase of the depression, at a time of very large unemployment, the benefit-paying states still collected substantially more than they paid out. This is not to argue that unemployment compensation is undesirable. On the contrary, its operation, particularly the automatic aspects, has many social and economic advantages. But it is important to note that, when the reserves are supplied by consumption-reducing taxes, the program continuously operates to contract consumption, except possibly during short intervals in the midst of depressions, and therefore will ordinarily tend to exaggerate existing deflationary influences.

THE TREASURY AND THE BOND MARKET

We have seen that the trust funds greatly lessen the dependence of the Treasury on the money market through providing it with an alternative market for its securities in periods of deficit financing. They also operate in a number of ways to strengthen the Treasury's position in the bond market when it does not require their entire supplies of cash for current expenditures. For example, the substantial use of short-term bonds and notes for financing the deficit during the depression has left the Treasury with heavy refunding requirements in the near future. The trust funds, however, supply it with current demands for its securities which should serve to strengthen the market in refunding operations, as well as to absorb the issues directly.

If the trust fund reserves, particularly the Old-Age Reserve Account, accumulate as planned, they will have the effect of placing a ceiling on the coupon rates, and to some extent the yields, of government bonds at around 3 per cent, which is the minimum yield required for the Old-Age Reserve Account. Should deficits not continue, the funds will absorb a substantial portion of the annually refunded debt, and this in turn might confront private investors with a serious investment problem. Insurance companies, trust and estates, banks, and other institutional and private investors are or feel compelled to carry substantial amounts of governments in their portfolios, and the competition for the gradually contracting volume of Treasury bonds may force them to seek new fields of investment and may serve to maintain the bond yields at unprecedentedly low levels. The aggregate cost

of the debt to the Treasury is likely to rise, however, as it is forced to refund short-term obligations into bonds. On the other hand, it might be noted that these developments may permit the banks to reduce their portfolios of governments without involving themselves in capital losses.

TABLE 4

PURCHASES OF GOVERNMENT SECURITIES BY TREASURY FOR INVESTMENT ACCOUNTS

(millions of dollars)

	1935	1936	1937	1938
January	5.4	18.5	14.4	−12.0 (sold)
February	1.3	4.5	5.7	−3.0 (sold)
March	41.0	32.7	119.6	23.3
April	−21.9 (sold)	19.0	11.9	2.5
May	23.3	15.8	3.9	−4.9 (sold)
June	8.8	30.5	24.4	.8
July	33.4	15.5	4.8	1.2
August	35.4	3.8	12.5	−3.9 (sold)
September	60.1	47.4	8.9	38.5
October	17.4	27.0	3.7	1.0
November	−18.4 (sold)	5.9	2.0	.4
December	5.3	24.2	−15.4	6.5

In addition to these broad effects, the trust funds also enable the Treasury to exercise a strong influence on the short-term fluctuations of the bond market. The Treasury is not legally permitted to enter the market directly through purchases with its General Fund balance, save to retire bonds for the Sinking Fund. Short of such outright retirement, it can only enter the market through its management of the trust funds and investment accounts (or the Stabilization Fund). Their income for investment flows in a fairly steady stream into the hands of the Treasury, and the latter can let the money accumulate over a period of weeks or months and can select the time of investment according to its own convenience. In so far as special securities are issued to the funds, this power is of no significance, but in the case of many of the funds their income is invested through direct open-market purchases of existing obligations. Consequently the ability of the Treasury to choose the *timing* of the purchase (or sale) and the particular issues bought (or sold) is an important instrument for influencing the market. Table 4 gives the purchases or sales of government securities by the Treasury for the Investment Accounts, as announced at the end of each month, 1935–38.

This control over the investment of the trust accounts could be used for what financial circles consider improper purposes, as, for example, to "rig" the market in preparation for a financing operation. It is the stated policy of the Treasury, however, not to use the funds for this purpose, and heavy purchases are reputedly not made in the period immediately preceding a financing operation. Furthermore, it is the policy of the Treasury to conduct its purchasing as far as possible on a declining market and to make whatever sales are necessary on a rising market. In this way it purports to manage the accounts in a profitable manner and incidentally tends to exert a stabilizing influence on bond prices.

However, the Treasury can and probably does use its discretion in the selection of issues to bolster up the weaker issues on the list. During 1936–37 the weakest points in the market were long-term, low-coupon issues and the new issues, and it is probable that in this period the Treasury managed its purchases so as to support them. This was, of course, perfectly natural and proper, since extensive purchases of other issues would presumably have further distorted rather than corrected the alignment of the market. But it does indicate the type of influence which the Treasury is able to exercise upon the market, especially in view of the fact that the market for governments is frequently thin. By strengthening critical issues the Treasury can give a fillip to the entire market.[28]

In the spring of 1937 the government bond market suffered a sharp collapse, the bond yields showing an average rise of around ½ per cent. The first break came on March 12, and the decline was halted for the time only by the intervention of the Federal Reserve System. The Treasury unfortunately was in the middle of a financing operation and, in accordance with its general policy, was presumably unwilling to buy through the trust funds, although it was rumored in the press that the Stabilization Fund acted as a temporary stopgap. Subsequent to the middle of the month, however, the market continued to decline, and the Treasury proceeded to utilize the cash of the trust accounts for its support.

In a press interview on April 1, Secretary Morgenthau discussed the relation of the Treasury to the bond market.[29] The Treasury

[28] Back in the fall of 1933, when the government bond market had declined severely as a result of the gold policy, Secretary Morgenthau announced that the Treasury had then supported the market, presumably through the trust accounts and Sinking Fund, *Commercial and Financial Chronicle*, December 2, 1933, p. 3875.

[29] *New York Times*, April 2, 1937, p. 33.

and the Federal Reserve System, he declared, by "working together" have ample funds to keep the government bond market orderly; since money was flowing into and out of the Treasury "all the time," there was a sufficiency for that purpose. He said, however, that he did not believe that, "ultimately," government support would make any difference, and that the Treasury had never attempted to exert direct influence:

> All we have ever tried to do was to use the government funds to *keep an orderly market*. As long as I am here, that is all we will ever try to do. Nobody has enough money to put the market up or down and I never would use funds for that purpose, but we have always tried to keep it orderly and will continue to do so.

During the month of March the Treasury purchased one hundred and twenty million dollars of government securities for the trust accounts, the bulk of the purchases presumably occurring after the mid-month financing. It might be noted that, in addition to these Treasury purchases, Federal Reserve Banks bought thirty-two millions of bonds in February, one hundred and thirteen millions in March, and ninety-eight millions in April, thereby adding ninety-six millions to their net holdings and reducing their notes by the remainder.

It is significant, moreover, to note how the Treasury managed to locate sufficient funds to purchase a hundred and twenty million dollars of bonds in two weeks. Part, of course, was supplied by the current cash receipts of the trust accounts and by such receipts as had previously been allowed to accumulate. But the principal source of the Treasury's resources is to be found in its redemption of seventy million dollars of the special Postal Savings notes and five millions of the special FDIC notes.[30] Seventy-five millions were thus made available for the purchase of bonds in the open market.

In September 1938 the government bond market suffered another rapid decline as a result of the European war scare, and in that month the Treasury purchased $38,500,000 of securities for the trust accounts. This time the bulk of the funds was obtained by a redemption of thirteen million dollars of the special 2 per cent Postal Savings notes and also the redemption of the entire issue of 2 per cent Government Life Insurance Fund notes amounting

[30] These transactions were shown on the *Daily Statement* for March 25, which was probably a week or so after they had occurred.

to twenty-five million dollars. These notes had been issued for the first time in June–July 1938, at a period when the government market was high, and the Treasury in so doing may well have had in mind their possible future utility in a market crisis.

The Treasury is at all times free to redeem its special issues of securities to the various trust accounts, thereby increasing the cash on hand of the accounts. This does *not* increase the cash resources of the Treasury, but it makes legally available to the Treasury funds for open-market purchases. As we have noted above, the Treasury is not permitted to use its General Fund balance for open-market purchases except to retire obligations for the Sinking Fund. The redemption of special securities is merely

TABLE 5

SPECIAL SECURITIES OUTSTANDING ON DECEMBER 31, 1938, WITH MINIMUM INTEREST YIELDS NECESSARY OR CUSTOMARY

	Securities outstanding (*millions of dollars*)	Minimum yield (*per cent*)
Postal Savings System	52	2
Federal Deposit Insurance Corp.	105	2
Government Life Insurance Fund	7	2
Unemployment Trust Fund	1064	2½[a]
Old-Age Reserve Account	862	3
Railroad Retirement Account	76	3
Employees' Retirement Funds	468	4
Adjusted Service Ctf. Fund	22	4
	2656	

[a] Average rate.

a method of circumventing the prohibition on open-market purchases which may be of great value in certain situations, such as March 1937 and September 1938. The limiting factor on the use of this method is the minimum interest yields required for most of the special securities. Thus the retirement funds and the Adjusted Service Certificate Fund require 4 per cent, and the Old-Age Reserve Account requires 3 per cent, so that until the market yields on governments rise to these levels the redemption of these special securities will not supply the Treasury with funds for market purchases. The important special issues for this purpose under present conditions are the two mentioned above, the Postal Savings and FDIC notes, and the Government Life Insurance Fund notes, if any such issue is again created. Their minimum interest yield is 2 per cent, which is amply covered by present

market yields. It should also be noted that the Unemployment Trust Fund certificates, with a minimum rate of the average rate on the federal debt, are also available in this respect, but they must be available for quick liquidation at any time, so that extensive market investment is not advisable for ordinary purposes.

In addition to the current receipts of the trust accounts and the redemption of the special issues, the Treasury can also make available funds for bond purchases by reducing the portfolio holdings of notes and guaranteed obligations and by utilizing the unneeded cash balances of various agencies.

While the experiences of March 1937 and September 1938 indicate the powerful resources which the Treasury can command through the trust funds and investment accounts for intervening at critical periods in the bond market, nevertheless Secretary Morgenthau was correct in denying that the Treasury alone could more than temporarily resist substantial and prolonged downward pressure. The resources required for such stabilization would necessarily be indefinitely large. The Federal Reserve Banks could achieve it by establishing a buying rate, since their power to make open-market purchases is ample under existing conditions.

SUMMARY [31]

The first years of experience with the Social Security program have illustrated how difficult it is for the federal government to undertake any comprehensive social activities without engendering important monetary repercussions. The necessary taxation and the changes in the flow and distribution of income have this result. They also illustrate the dangers of using criteria developed in private business for the operation of the public business. The development of the Old-Age Reserve Account, the Railroad Retirement Account, and the Unemployment Trust Fund has had, and will doubtless continue to have, profound effects upon our economy in general and upon the position and power of the Treasury in particular. Undoubtedly, whatever form the financing of these activities might have taken, there would have been significant collateral effects. Their establishment along lines of private actuarial practice with a view to their "self-sustenance" and the consequent plans to build up huge reserves in the case of the pension funds have enhanced the accompanying monetary difficulties.

[31] The views expressed by the writer throughout this article in no way represent the official views of the Treasury Department, with which the author was formerly connected.

It is well to remember that the Social Security funds, although the largest in size and rate of growth, are not the only ones of importance. There are also the retirement funds, the Life Insurance Fund, the reserves of the Federal Deposit and the Federal Savings and Loan Insurance corporations, the Postal Savings System, and some sixty-odd other trust accounts managed by the Treasury. All of these in the aggregate have some significance for the general monetary situation or for the position of the Treasury.

In the first place, the more important of the funds obscure the budgetary picture by creating a divergence between the formal budget and the actual net cash receipts or expenditures of the government. In the case of the Old-Age Reserve and Railroad Retirement Accounts, non-cash expenditures are offset by cash receipts from the pay-roll and carriers' taxes, while appropriations to the retirement funds also need not be met in cash (for the most part) but can be paid in the form of government securities. On the other hand, the Unemployment Trust Fund and many of the other funds and accounts supply the Treasury with a sizable demand for its obligations and thus a current source of cash unaffected by budgetary considerations. As a result, the dependence of the Treasury on the market to finance deficits or to meet maturities is greatly lessened. In the fiscal year 1937 the Treasury required around two and a quarter billion dollars of funds to finance a budget deficit of three and two-tenths billions. In the fiscal year 1938, despite a deficit of one and four-tenths billions, the Treasury almost covered its cash requirements from trust fund receipts. In addition to this relief for Treasury financing, the trust funds also deprived the budget of any economic significance, since the important factor is the net cash contribution of the government to the community's income. Thus, if any stimulation to business activity is to be achieved by government spending, there is no way of escaping the stigma of budget deficits in excess of the current income from the trust account. Moreover, if the deficits fall below that current income an actual reduction of debt outstanding in private hands will occur.

Second, it appears that any reduction of debt in private hands as a result of the trust funds is almost certain to be deflationary, unless it should occur at the height of an investment boom, when it might stimulate the capital markets. The pay-roll taxes reduce consumption expenditures, while the redemption of privately held debt (or the obviating of new issues which would otherwise be

necessary) merely adds to the capital market funds which are likely to remain unused under present conditions. Should the deficit decline in the future and the projected accumulation of the Old-Age Reserve Account occur, this tendency will be very much accentuated.

In the third place, the Treasury is invested with considerable opportunities to provide compensatory action in the cyclical movements of business activity. It can restrain booms by hoarding the trust fund receipts, while the Unemployment Trust Fund operates to increase net cash expenditures at certain periods in a depression without involving a budgetary deficit. The real problem, however, arises in the recovery period as a result of the consumption-reducing character of the Social Security taxes. So long as the government is willing to incur a large deficit, it can stimulate recovery, but whenever the transition occurs from net cash disbursements to actual budgetary balance, the recovery movement may be nipped prematurely. In this phase, the Old-Age Reserve Account in particular is an aggravating factor which the Treasury finds it difficult to circumvent.

Finally, the Treasury's position as manager of the trust account investments provides it with extraordinary influence over the government bond market through its discretion regarding the timing of purchases and the particular issues to be bought. This influence was well illustrated in March 1937, when the Treasury purchased some one hundred and twenty million dollars of bonds in two weeks for the purpose of supporting the collapsing market, and in September 1938, when it purchased thirty-nine millions. While the Treasury cannot use the General Fund for purchase except to retire debt, it can use the current and accumulated balances of the trust accounts; it can shift securities within existing portfolios; and it can redeem the special obligations issued to the trust accounts and replace them with open-market purchases wherever minimum yield requirements permit.

The retirement funds, the banking reserves, and the small investment accounts are strongly entrenched and are themselves of minor importance. There is little doubt concerning their future continuance. The Social Security funds, however — in particular, the Old-Age Reserve Account — seem destined to encounter both economic and political difficulties. They cannot succeed in their actuarial objectives without causing deflationary effects which would probably prove economically unbearable. Moreover their

purported actuarial justification is probably unsound in our economy.

Political difficulties are involved because, on the one hand, the accumulating funds may strain the actuarial rectitude of Congress to the breaking point, and, on the other hand, administrations will find the budgetary aspects of the funds politically disadvantageous unless the American passion for balanced budgets should completely subside.

From the standpoint of monetary policy in general, it is apparent that the trust funds, like numerous other primarily nonmonetary activities of the government, add to the complexity and difficulty of determining and effectuating policy. They constitute further evidence that the days of nonpolitical and relatively simplified control through the rediscount rate and open-market operations are gone. These two instruments are still important, but so are a score of other government activities which have their source in Congressional legislation and their management in sundry different agencies. In so far as discretion is permitted in the management of the trust funds, the Treasury is the chief recipient, and its already dominant position in monetary matters, as a result of other powers and activities,[32] is further strengthened.

[32] See the present writer's *The Treasury and Monetary Policy, 1933–1938* (Harvard University Press, 1939).

A STUDY OF LABOR MARKET CONTROL

Robert Frase

CHANGES IN THE LABOR MARKET IN GERMANY AND ENGLAND

THE control and regulation of the labor market is a governmental activity which has developed during the last forty years and has expanded so much in the last decade that examination and appraisal of it is an essential part of any broad discussion of public policy. This paper will deal for the most part with German experience, and especially with developments in this field in Germany since January 1933. Germany has been selected for purposes of discussion because it furnishes the best illustration of (1) the extended development of a public employment service in a democratic nation, and (2) the uses to which this machinery may be put in a dictatorship or in time of war.

The expression "regulation and control of the labor market" as used in this paper means the attempt by government to modify such a distribution of labor as would otherwise take place. This interference with "natural economic forces" may vary in extent. In most countries it has been small, confined largely to making the market for labor function more effectively by bringing together unemployed workers and employers. But the machinery which serves this purpose may also be put to other uses, and the "regulation of the labor market" then develops into the "regulation of labor," or the allocation of the human resources of the nation to various parts of the economy in order to achieve certain objectives. This paper will deal particularly with this second type of regulation.

It is significant that shortly after the Nazi revolution of 1933 the old term *Arbeitsmarkt* was consciously displaced by the coined word *Arbeitseinsatz*. This shift in terminology reflects exactly the change in attitude and purpose that had occurred in Germany.[1] It

[1] "Es bedeutet mehr als nur die blosse Umprägung von Worten, wenn schon bald nach der Machtübernahme an Stelle der Bezeichnung 'Arbeitsmarkt' der neue Begriff 'Arbeitseinsatz' sich durchsetzte. Tatsächlich sind die Tätigkeit und Einwirkungsmöglichkeiten der Arbeitsämter im Zeichen der Arbeitschlacht auf eine vollkommen neue Grundlage gestellt worden." *Zehn Jahre Reichsanstalt für Arbeitvermittlung und Arbeitslosenversicherung, 1927–37* (Berlin, 1937), p. 28.

is possible to control and direct a labor market, just as it is possible to control a wheat market, or a stock market; but, so long as the "market" remains, the exchange that takes place there is a voluntary economic one and the controlling factor is price. When the distribution of labor resources is no longer left primarily to custom and the free play of the price system, the use of the term "market" is an anachronism.

In Germany prior to 1933 the interest in the problems of the labor market was much more widespread than in any other western country, but the nature of this interest was not essentially different from that taken by the few persons interested in the labor market in, say, Great Britain or the United States. *Arbeitsmarktpolitik* was a recognized subdivision of *Sozialpolitik*, and as such carried the connotation that the welfare of the nation, and more particularly of the working class, could be improved by deliberate and planned action on the part of organized groups or on the part of the state. But in this belief in conscious and planned activity Germany was not so much different from Great Britain and the United States as she was in advance of them in the course of historical development. For several reasons — and this subject has been treated so often and well by others that repetition here is superfluous — confidence in the beneficent working of an unregulated and uncontrolled system of *laissez faire* was never as strong in Germany as in English-speaking countries. Aside from protection, the earliest concrete manifestation of these doubts about the liberal economic system in Germany was social insurance, and the regulation of the labor market followed not far behind.

ESTABLISHMENT OF FREE PUBLIC EMPLOYMENT OFFICES

Starting in the nineties of the last century in Germany there was a phenomenal growth of employment offices operated by labor unions, employers' organizations, employers and workers acting together, and municipal authorities. The first municipal office was started in 1894, but the idea spread rapidly among the cities and towns and even the German states, principally because local officials hoped that this device would help them cope with unemployment. Employers' offices and trade union offices, on the other hand, were weapons in the economic struggle. If labor unions could secure jobs for their members, their strength would increase,

and, conversely, employers' organizations could use their placement offices for recruiting nonunion labor.

In the year 1910 all these types of employment offices (excluding the purely commercial fee-charging offices) placed more than two million workers in jobs.[2] In 1913 there was a total of over five hundred public employment offices, and some states, Prussia for example, had required all towns over a certain size to establish municipal public employment offices.[3] These municipal and state offices had banded together in a number of federations through which the clearance of positions between towns could be accomplished. The Reich had paid a small subsidy to these federations beginning in 1908, but in general took the attitude that this activity should be left entirely in the hands of the states and municipalities.[4]

In England during this same period, from 1890 to 1914, interest in the labor market developed much more slowly. One reason for this was the centralization of poor-relief in Great Britain under the Poor Law Amendment Act of 1834, which rather effectively discouraged any local government — and local governments were also less independent and autonomous than the German towns — from exploring remedial measures like public employment offices.

Under the stimulus of the heavy unemployment of 1902–04, however, the rather obvious idea of establishing public employment offices was accepted in part; and the Unemployed Workman Act of 1905, which was a mixture of emergency remedies designed to relieve the stringency of the old poor-law system, provided that local distress committees might establish public employment offices if they saw fit.[5] It was through his work with one of these committees that Sir William Beveridge, the first and the most outstanding British student of the labor market, became interested in these problems. The first comprehensive public survey of unemployment and the related problems of the labor market was that made by the Royal Commission on the Poor Laws, which began its investigation in 1905 and presented its report in 1909. It was in the famous minority report of this Commission and

[2] Emil Meyer, *Entwicklung und gegenwärtiger Stand der Arbeitsvermittlung in In- und Ausland* (Hanover, 1912), p. 15.

[3] Oscar Weigert, *Administration of Placement and Unemployment Insurance in Germany* (New York, 1934), p. 34.

[4] Dr. Hans Volmer and Dr. Hans Henschel, *Der Arbeitseinsatz* (Berlin, 1937), pp. 12ff.

[5] Unemployed Workman Act, 1905 (5 Edw. VII), sec. 1 (1).

Beveridge's classic volume, *Unemployment: A Problem of Industry*, which appeared in 1909 and 1908 respectively, that the first careful presentations of the problems of the British labor market appeared. The analyses of these two works were very similar:

1. Unemployment is not to be attributed to the moral failings of individual workers, but rather to somewhat mysterious cyclical economic fluctuations.
2. Much of the problem of poverty is not due to unemployment so much as to "underemployment," or less than full-time work, in seasonal industries and in casual labor.

Just as the first students of unemployment in Germany and the United States came at the problem from the conditions of the unemployed rather than from general economic analysis, and therefore suggested remedies for the symptom of unemployment rather than for the cause of cyclical fluctuations in business activities, so, too, in England Beveridge and the minority of the Royal Commission suggested remedial measures having to do with the labor market.[6] They proposed the establishment of a network of free public employment offices on the German model, in the belief that this machinery would not only bring into being for the first time a real national labor market rather than a myriad of badly connected local labor markets, and thus help to eliminate aimless tramping of the streets as the method of finding work, but also that a system of public employment offices would result in the elimination of pools of casual labor around each employer of such labor and would make it possible for seasonal laborers to achieve a reasonable continuity of employment by going from one seasonal trade to another at different times of the year. This analysis was later to prove far too optimistic, but without it, and without the espousal of a system of free public employment offices, the employment exchange system of Great Britain would not have been established in 1909.

Both the minority of the Royal Commission and Beveridge also recommended that unemployment insurance be tried, either in the form of state subsidies to the already existing out-of-work benefit plans of British trade unions, the Genf plan of subsidized trade-union unemployment insurance which was already in operation in several European cities, or in the form of a wholly gov-

[6] Royal Commission on the Poor Laws, vol. III, Minority Report (Cmd. 4499, 1909), pp. 635ff.; W. H. Beveridge, *Unemployment: A Problem of Industry* (3rd edition, London, 1912), pp. 197ff.

ernmental undertaking.[7] Beveridge and Llewelyn Smith, who were officials of the Board of Trade, drafted the Employment Exchanges Act of 1909 with the idea that an Unemployment Insurance Act would be passed in 1911, realizing that a system of employment offices was necessary to the administration of a compulsory unemployment insurance system. These two measures were accepted by the Liberal government of the time, and the program went through exactly as planned. Shortly after the war the unemployment insurance system, which in 1911 applied only to the seven industries of building, works of construction, engineering, iron-founding, shipbuilding, construction of vehicles, and sawmilling, was extended to cover the entire industrial wage-earning population of Great Britain.[8]

WARTIME EXPERIENCE: GERMANY

An examinaton of the role which the public employment services of Germany, Great Britain, and the United States played during the World War shows very clearly the way in which this segment of a national economy can be controlled and directed by a consistent and far-reaching attempt at planning to reach certain economic objectives, whether those economic objectives be set in terms of ultimate ends of a military or a peaceful variety. But because the primary purpose of this paper is to portray and discuss a system of labor-market control and regulation which is far more highly developed than that which these three countries managed to improvise during the brief period of the war, this wartime experience will be sketched very briefly.

The system of public employment offices in Germany on the eve of the World War was really not a system at all. There was a large number of public employment offices scattered throughout

[7] Royal Commission on the Poor Laws, *op. cit.*, p. 680; Beveridge, *op. cit.*, pp. 228ff.

[8] The history of the development of public regulation of the labor market in the United States prior to the war follows still another pattern, and in general is not as instructive as the story of this expansion in Germany and Great Britain. There was a small movement toward the establishment of free public employment offices by states and municipalities as early as the nineties of the last century, but for the most part the interest taken in the labor market was in the direction of limiting immigration and regulating the activities of private and commercial employment offices, which (like those in France) were very often shady, racketeering organizations which overcharged and even defrauded the casual workers who patronized them. Cf. Harrison and associates, *Public Employment Offices* (New York, 1924).

the country, most of them managed and financed by the local governments; and these offices filled a great many positions each year. As far as filling jobs was concerned, the German pre-war offices were much more effective than those of Great Britain, and the few American offices are not even worthy of comparison. Nevertheless, for war purposes, the German offices were less effective than the British offices, for the simple reason that the latter was a national system, with regional and local offices grading down from headquarters, which made possible the carrying-out of national objectives through centralized direction and control. The Germans early in the war tried to create a national system of labor offices by establishing a Central Office for Placement,[9] which started to issue a national job-clearance sheet. This clearance sheet was discontinued after two issues because it could not be issued rapidly enough, and it was realized that such a publication could not take the place of a nation-wide administrative organization. The wartime work that was done by the German employment offices and employment office federations was directed by the Ministry of War.

WARTIME EXPERIENCE: GREAT BRITAIN

The use of the public employment service in dealing with the problems of labor supply and regulation during the war was carried much further in Great Britain than in any other country. This experience has been recorded in great detail in a book by Humbert Wolfe.[10] In the introduction there is an admirable brief description of the problem:

> The ideal method of solving the problem, as it would be conceived apart from the actual facts of each nation's situation, would be first to decide the proportion to be allocated respectively as between the combatant forces and the civilian workers; then to augment the available workers by bringing in new recruits from at home or abroad; then to distribute the civilian workers so augmented, according to the respective urgency of the claims of each service, to munitions, to the supply of necessities of life, and the maintenance of export trade; then to secure the utmost production from the workers by forbidding stoppages of work, by removing any circumstances which might tend to restrict output on work thus rendered continuous, by requiring the longest hours and the most

[9] Reichszentrale für Arbeitsnachweise bei dem Reichsamt des Innern, which issued the "Arbeitsmarkt-Anzeiger" (Volmer and Henschel, *op. cit.*, p. 13).

[10] *Labour Supply and Regulation* (Oxford, 1923), in the series, Economic and Social History of the World War.

efficient work during those hours compatible with health, by requiring workers to go where they were required, and to stay there as long as they were required. That is the ideal attainable in the absolute form only in the words of Aristotle when the material to be handled is not man but ἢ θηρίον ἢ θεός. . . . But though this ideal is unobtainable, it must be pursued. It implies for its achievement a central State Machine fully equipped with experience, exact knowledge, and power.[11]

There was the nucleus of just such a machine in the system of public employment exchanges which had been set up since 1909; as the war progressed this machine was expanded, and a larger and larger proportion of the work of regulating and controlling the labor market was transferred to it from other governmental agencies. The task of deciding which men in which occupations should be retained at home for the production of munitions and other necessary goods and services was not turned over to the employment exchanges as completely as it would be in similar circumstances again; and for most of the period of the war the badges which protected skilled men from the recruiting officers were given out by the War Office, the Admiralty, and a number of other agencies. No one had any exact knowledge of the occupations necessary for home production, nor any idea of the number of men in those occupations; so even after the badging scheme was introduced it was far from being as effective as it might have been.[12] But with the establishment of the Ministry of National Service in 1917, the employment exchanges were used for more of this work, and an arrangement which worked in a rough-and-ready fashion was finally evolved.

The employment exchanges were used much more extensively from the beginning in recruiting additional men (and women) for the munitions industries, and in this they were more successful, playing a predominant role in the replacement of the men drawn to the colors (3,230,000) by 2,439,000 other men and women.[13] In the equally important problem of keeping men where they were required, reducing the amount of labor turnover, and preventing employers from bidding men away from each other, no such success was achieved; but this failure can hardly be attributed to the employment exchanges. Section 7 of the Munitions of War Act, 1915, provided that men on munitions work (broadly

[11] Pages 3–4.
[12] *Ibid.*, Chap. IV.
[13] *Ibid.*, p. 96.

defined) could not get new jobs on munitions work if they did not obtain a leaving certificate from their last employer stating that their leaving was with the employer's consent. This was a workable device administratively, but it broke down under the storm of protest it evoked from the trade unions.[14]

Space will not permit any further discussion of this British wartime experience with the regulation and control of the labor market, but the role of the employment exchange system in it may be summed up by a further quotation from Wolfe:

> Whatever may be the value of the system of Employment Exchanges in peace time, there are no arguments against their existence in war time. Indeed, it would be true to say that if the Exchanges had not existed before the War, the War would have invented them. . . . A machine actually was in existence which could present from day to day a clear picture of the demands for labour from all parts of the country, and the possibility of satisfying the demands. It presented the G.H.Q. of civilian production from the outset of the War with exactly that scientific classification of man-power for their purposes, which was painfully sought and never completely obtained by the authorities responsible for the control of the whole man-power of the nation. As a direct result of the existence of the exchanges, the needs and means of supplying the needs of industry were known, and what was more, a means was in existence by which the needs could be tested.[15]

WARTIME EXPERIENCE: UNITED STATES

In the United States the World War actually brought into being for the first time a national employment service, and, had the war continued longer, this service would undoubtedly have played an important role in dealing with the problems of labor supply and regulation. There had been since 1907 a Division of Information in the Bureau of Immigration in the Department of Commerce and Labor which undertook to help immigrants to settle more successfully; and in the period between its establishment and the entrance of the United States into the war, the Division had gradually expanded the scope of its activities to include a small amount of actual placement.[16] The name of the organization was changed to Employment Service in 1914, and later the term "United States

[14] *Labour Supply and Regulation*, Chap. XII.

[15] *Ibid.*, pp. 66–69.

[16] Darrell H. Smith, *The United States Employment Service* (Baltimore, 1933), pp. 1–13. The number of placements was about 11,000 in the fiscal year 1915 and 75,000 in the fiscal year 1916.

Employment Service" was used for the work of placing nonimmigrants.[17] Immediately after the United States entered the war, the United States Employment Service was made use of in the problem of recruiting skilled labor for war industries and bringing in new supplies of female and juvenile labor, and in other wartime activities similar to those which have been discussed in connection with the British experience, except that the problem in the United States was largely to recruit an additional labor force rather than allocate skilled labor to the spots at which it was needed most.

In June 1918 the War Labor Policies Board reached the decision that all recruiting of industrial labor for private and public work connected with the war should be "conducted through or in accordance with methods authorized by the United States Employment Service."[18] This brought a further increase in duties and accomplishments, and by November 1918 the Service had increased its placements to over five hundred thousand a month.[19] In the fiscal year ended June 30, 1919, the Service was a $6,000,000 organization with a network of over two hundred of its own or coöperating offices all over the country.

POST-WAR READJUSTMENTS

After the war and the period of demobilization, the public employment services of these three countries suffered entirely different fates. The German service continued to expand and, through a series of legislative acts from 1920 to 1927, came under more central direction and control. The English service was swamped by the burden of paying unemployment insurance benefits all through the twenties; nevertheless, a continued improvement of administrative machinery took place during this entire period, and new services were gradually added. The United States Employment Service was the most seriously affected. Since it was regarded as an emergency wartime agency, its far-flung system of field offices was quickly junked or turned over to the states, and the Service reduced to an annual appropriation of about $200,000 per year, most of which was spent in making the Service a clearinghouse for statistics and information. Not until the pas-

[17] *Ibid.*, p. 12.

[18] Department of Labor, *Annual Report*, 1918, p. 701, quoted in Smith, *op. cit.*, p. 23.

[19] Smith, *op. cit.*, p. 42.

sage of the Wagner-Peyser Act of 1933, which established the present federal-state public employment office system, was there again even a semblance of a national public employment service in the United States.

Before turning to a detailed discussion of the developments in Germany from 1927 to 1937, a summary of the services which a public employment office system could and did provide in the liberal, pre-depression economies of western countries may be in order:

1. The essential service of such a system was to serve as a clearinghouse in each locality for jobs and workers.
2. To a lesser extent, the system served to bring jobs and workers together from various parts of the country, through the operation of a clearance mechanism.
3. In Germany, and to a lesser extent in England, the system had been expanded to take in vocational guidance service to children leaving school, and the placement of these school-leavers in jobs.
4. In both Germany and England the network of offices had proved indispensable to the administration of any kind of formalized unemployment relief or unemployment insurance system.
5. These same facilities of offices and trained personnel were used for the recruitment of unemployed persons for work-relief or public works projects.
6. In Germany, and to a much lesser extent in England, these offices also undertook the vocational training or retraining of unemployed persons to fit them for work in occupations in which employment opportunities were better.

It will be seen from this list of activities that the employment offices could hardly be said to have exerted any control over either the employer or the worker. The labor market was still a market, and the controlling factor in that market was the supply of and the demand for labor. The offices did help to bring the two parties together in the market place; they helped labor by advice in the form of vocational guidance and sometimes undertook some vocational training; and they carried on the job of administering unemployment insurance and relief.

GERMAN EXPERIENCE, 1927–33

The basic administrative structure of the Reichsanstalt für Arbeitsvermittlung and Arbeitslosenversicherung [20] has made the

[20] Federal Institute for Placement and Unemployment Insurance; hereafter referred to as the Reichsanstalt.

developments which will be outlined in the following pages possible; therefore the law of 1927 which first established this structure deserves rather detailed comment. The Arbeitsvermittlung und Arbeitslosenversicherung Gesetz (AVAVG) of 1927[21] was a compromise which resulted from the struggle between two groups of persons interested in unemployment relief and the labor market, the centralizers, represented by the Federal Ministry of Labor, and the believers in local autonomy, represented by the strong towns and cities. The details of this long struggle are interesting, but do not have a direct enough bearing on the central point of discussion to merit more than brief mention here. The bare outlines of the development are these: After the war the heavy and continuous unemployment, which was a new phenomenon in Germany, as it was in Great Britain, required the establishment of a more comprehensive and systematic scheme of unemployment relief than had theretofore existed, and the financial weakness of the municipalities made necessary the use of the taxing power of the Reich. The system of unemployment relief gradually expanded and developed during the immediate post-war years, until there had appeared as a result of the law of 1925 a system which was closely akin to a state unemployment insurance scheme, with pay-roll taxes and a definite relationship between contributions made by employees and their subsequent benefits when unemployed.

The Ministry of Labor officials who had drafted this system, and had come to have a considerable degree of control over its administration, were familiar with the development of unemployment insurance in Great Britain, and were anxious to set up a similar national system in Germany. The municipal welfare officials were not entirely opposed to the idea of unemployment insurance, especially in view of the relief which it promised to their local tax rates and budgets; but they had a strong and long tradition of administrative autonomy in general, and particularly with respect to these two related functions of unemployment relief and public employment offices. There were also political elements involved: the reluctance of the states and municipalities to see an extension of federal power, and the distrust of the Social Democrats at having functions removed from the cities, in which they were strong, and given to the federal government, in which their position was relatively weaker. The final compromise, which was

[21] *Reichsgesetzblatt*, pt. I, p. 187.

only accepted after a vigorous campaign by the Ministry of Labor and an extended discussion in the professional journals of the welfare workers and public officials, was in reality a victory for the advocates of centralization and coördination.[22]

The most important aspect, from the point of view of this discussion, of the administrative organization which was set up to administer the AVAVG, was the fact that, for the first time in German administrative practice, a federal agency was set up with regional and local offices of its own throughout the entire country. This was a distinct departure from the traditional method of doing things in the German federal state, which had been to entrust the states with the enforcement and administration of federal statutes. The Reichsanstalt, the newly created federal agency under the supervision of the Ministry of Labor, was authorized to establish regional offices and local offices, and to define respectively the regions and districts in which these offices should function (this last with the approval of the administrative committees of the local offices and the highest state administrative authorities).[23] The fashioning of this new regional organization was not completed at once, nor was the carving out of the new regions and districts done strictly with regard to economic conditions and to the disregard of political considerations and traditional political boundaries, but in the main the thirteen new regions were far better adapted to the economic geography of the country than the German states had ever been. Slight changes in boundaries and the elimination or addition of local offices have occurred every year since 1927, but on the whole the regional pattern then set up has been maintained ever since.

The new organization took over the offices and the staffs of the existing state and local public employment offices, and there was thus a nucleus of trained personnel with which to start. A number of other officials were brought in by transfer from other government services, especially for the higher positions. In fact,

[22] For a brief discussion of the attitude of some local officials after the AVAVG had been passed, see Stadtrat Schmidt, "Die Gemeinde und die Organisation der Reichsanstalt für Arbeitsvermittlung und Arbeitslosenversicherung," *Arbeit und Beruf*, vol. VII, Nr. 23, pp. 625ff.

[23] Paragraph 2, subsection 2, AVAVG: "Der Vorstand der Reichsanstalt kann nach Anhörung der Verwaltungsauschusse der Arbeitsämter oder landesarbeitsämter in Benehmen mit der obersten Landesbehörde die Grenzen der Arbeitsämter und der Landesarbeitsämter unter Berücksichtigung wirtschaftlicher Zusammenhänge ändern; er kann Bezirke zusammenlegen, Einrichtungen aufheben und nach Bedarf neue schaffen."

it might be said that the local offices were staffed by persons with employment service experience and background, while the very highest positions fell to officials from the Prussion and federal civil services. This last was not unimportant, as the developments of the next few years were to demonstrate. Only a very small proportion of the initial staff of the Reichsanstalt — and most of these were persons transferred from other departments and agencies — was given the status of *Beamten*; the vast bulk of the personnel were *Angestellten*, and have remained so. The first president, or chief executive officer, of the Reichsanstalt was Dr. Friedrich Syrup, a professional civil servant who had come up through the Prussian service. He is still in office.

The second important fact about the Reichsanstalt was that it was given complete and exclusive jurisdiction over the new system of unemployment insurance which was established by the AVAVG, and over placement, vocational guidance, and (with the approval of the Ministry of Labor) all regulation and control of the labor market.[24] Thus for the first time all these related activities were brought together under the control of a single federal administrative agency. This centralization and concentration of authority was offset by the formation of the Reichsanstalt as a "self-governing body," on the pattern of self-government by committees representing employers, employees, and the public which had grown up in Germany many years before in connection with social insurance legislation. These self-governing bodies or committees were set up at the head of the Reichsanstalt as a whole, of the regional offices (*Landesarbeitsämter*), and of the local offices (*Arbeitsämter*). In each case there was also an administrative officer, who acted as chairman of the committee. Each organization unit had a considerable amount of autonomy; but the regional offices could override the local offices on some points, the headquarters office could do the same for the regional offices, and the Ministry of Labo: had certain powers over the Reichsanstalt as a whole.

[24] Paragraph 1, AVAVG: "(1) Trager der öffentlichen Arbeitsvermittlung und Arbeitslosenversicherung im Deutschen Reich ist der Reichsanstalt für Arbeitsvermittlung und Arbeitslosenversicherung.

"(2) Der Reichsanstalt liegt auch die öffentliche Berufsberatung und Lehrstellenvermittlung ob. Weitere Aufgaben zur Regulung des Arbeitsmarkts kann sie mit Zustimmung des Reichsarbeitsministers übernehmen. Auch kann ihr der Reichsarbeitsminister solche Aufgaben entweder als eigene Angelegenheit übertragen oder sie damit unter dem Vorbehalte beauftragen, dass sie an seine Weisungen gebunden bleibt."

Another element in the compromise — and this was a sop to the municipalities — was the fact that the public members of the governing committees were not, as in American advisory councils, merely prominent citizens, but representatives of the municipalities, almost always in practice municipal officials. In the regions and cities where the Social Democrats were in power, this meant, of course, a clear working majority of employees and public representatives.

The Reichsanstalt as a whole really had two governing bodies, the Administrative Council (*Verwaltungsrat*) and the Executive Committee (*Vorstand*). The first was made up of the president, as chairman, and thirteen members from each of the three groups. The Executive Committee was composed of the president as chairman and five members from each group, chosen by the Minister of Labor from among the members of the Administrative Council. In practice these self-governing committees restricted their activities for the most part to important administrative regulations, changes and modifications of general policy, and the budget. Routine administration and most lesser policy matters were left to the president of the Reichsanstalt, the presidents of the regional offices, and the directors of the local offices, respectively. The method of operation was much the same as that in certain independent federal boards in the United States, in which an executive officer is selected to carry out the strictly administrative work.

Before leaving this description of the organization of the Reichsanstalt and the provisions of the AVAVG, it should be mentioned that the law permitted a vast amount of administrative discretion to the Reichsanstalt, and even more to the Federal Ministry of Labor. Much of the law was in the nature of a grant of power, to be filled out in detail by administrative regulations of the Ministry of Labor or of the Reichsanstalt. For example, in addition to the unemployment insurance system which was set up in the law itself, a system of federal unemployment relief was authorized in times of heavy and long-continued unemployment on the order of the Minister of Labor (with the consent of the Administrative Council of the Reichsanstalt).[25] This reserve of administrative discretion was to be used very frequently during the years of heavy unemployment which followed immediately after the establishment of the Reichsanstalt, and its use was to establish a precedent and example to the Nazis when they came into power in 1933.

[25] Paragraph 101, AVAVG.

It should not be assumed, however, that the reserve authority of the Reichsanstalt was made use of immediately, or that the creation of this federal agency made possible the immediate co-ordination and standardization of administrative practice throughout the entire system.[26] The feeling of local autonomy was still very strong, and it would have been distinctly unwise for the headquarters officials of the Reichsanstalt to move too rapidly in this direction. Especially strong were the regional offices, and in many fields they carried on without a great deal of supervision from headquarters. To use a small technical point for purposes of illustration, it was September 1936, more than three years after the Nazis had come into power, before the headquarters office of the Reichsanstalt began to prescribe the arrangement of certain standard placement forms; prior to that time each regional office had decided this matter for itself. It was not until 1935 that a central school for the in-service-training of the thirty thousand employees of the Reichsanstalt was established in Berlin; and it was in the same year that a central office for the clearance of jobs throughout the whole country was first established. These are some examples of the slowness with which centralization of control and the standardization and coördination of procedure were introduced prior to 1933.

Nevertheless, other examples could be cited to show that in the years from 1927 to 1933 the headquarters did pursue a policy of gradually centralizing control, at least with relation to general policies. I suspect the gradual drift in this direction was a deliberate policy on the part of leading headquarters officials, but to a considerable measure it was also forced by circumstances during those years of incredibly heavy unemployment. Financial needs made it necessary for the Reich government to sweep aside many of the nice balances between federal control and local autonomy which had been set up in the AVAVG; and the fact that the states and municipalities were rapidly going bankrupt weakened their powers of resistance to this change. One of the first things to go was the very elaborate scheme of creating different unemployment insurance contribution rates for each region, which was designed to set up a certain minimum contribution rate for the country

[26] For an extended discussion of the administrative organization and functioning of the Reichsanstalt in 1936, see "The Administration of Unemployment Insurance and the Public Employment Service in Germany," by Robert Frase (United States Social Security Board and the Social Science Research Council, multilith, 166 pp., for limited distribution, January 1938).

as a whole but to permit any region which had built up a certain reserve to reduce its contribution rate. It was a geographical version of the Wisconsin system of unemployment insurance in the United States, in which each employer builds up his own reserve for his own employees, and, if he has a good record of employment, his contributions are diminished.[27] This arrangement was set up in the statute, with the provision that it was not to go into effect until a reserve sufficient to pay unemployment insurance benefits to six hundred thousand workers for three months had been accumulated under a uniform contribution rate of 3 per cent of wages. This reserve was never accumulated; and indeed the contribution rate soon had to be raised by degrees until it had reached the figure of 6½ per cent of wages in September 1930, at which level it still stands.

THE NAZI CAMPAIGN AGAINST UNEMPLOYMENT

This then was the basic legislation and the administrative organization which the Nazis took over in 1933. It was a much more coördinated system of labor market legislation than existed in any other country (with the possible exception of Austria) because unemployment insurance, unemployment relief, vocational guidance, work relief, vocational training and rehabilitation, recruitment for public works, and other related matters had been brought together under the direction of one federal administrative agency. On the other hand, it was less centralized administratively than the British system, which had been built up from its earliest beginnings as a national administrative agency, at first as part of the Board of Trade and then later as the largest part of the Ministry of Labor, with no trimmings of local autonomy or self-governing committees. There were enormous powers authorized by the legislation itself, but, except to curtail benefits and to impose other restrictions on benefit rights in the interest of economy, they had not been used to any considerable extent.

When the Nazis came into power in 1933, perhaps their most important domestic policy was the reduction — in fact, the elimination — of unemployment. Hitler and his lieutenants had shouted from the housetops that they would accomplish this miracle, but once they got into office they were naturally somewhat at a loss as to how to begin. They had a magnificent instrument ready to hand in the machinery of the Reichsanstalt and its trained staff

[27] *Ibid.*, p. 129; and paragraphs 153–163, AVAVG.

in regional and local offices all over the country. Perhaps in anticipation of making use of this efficient machine, or perhaps by accident, the Nazis did not undertake a wholesale and indiscriminate change in the personnel of the Reichsanstalt, and the institution remained to a considerable degree free of this attention for several years. In its annual report for the fiscal year ended March 31, 1934, the Reichsanstalt reported that 3,344 officials and employees out of its total personnel of approximately 26,500 had been let out, retired, or demoted because of the changes made necessary by the "national revolution." [28] The same solicitude was not shown to the whole system of "self-government" of the Reichsanstalt. By a series of orders in the summer of 1933 the powers of the administrative committees were stripped away (in headquarters, regional offices, and local offices) and transferred to the president of the Reichsanstalt, the presidents of the regional offices, and the directors of the local offices.

The Nazi campaign against unemployment was not formulated all at once, nor indeed did it take on the aspects of a consistent policy until a year or two after January 30, 1933; but from the beginning it was composed of two major elements. The first, and by far the most important in the long run, was the program of greatly increased public expenditures for public works and for rearmament. It is not at all surprising that this program was initiated in something less than a deliberate fashion; the theory of getting out of depressions by heavy government expenditures was hardly more than the germ of an idea in the minds of unorthodox financial and economic theorists at the time. Just as the federal government of the United States drifted into deficit financing because of the need for furnishing unemployment relief, and only later rationalized this action in terms of a deliberate economic policy, so too the Nazis probably launched public works and other forms of government expenditure only with the thought of the direct employment that these measures might create in the first year or two of their regime. The point at which the German government went over to the theory that heavy government expenditures would serve as a stimulus to the recovery of the private economy cannot be precisely indicated, but public works and rearmament programs were started almost immediately after the Nazi revolution. Previous governments had made a start in this

[28] *Sechster Bericht der Reichsanstalt für Arbeitsvermittlung und Arbeitslosenversicherung* (Berlin, Reichsdrucherei, 1935), p. 39.

direction with the work-relief appropriations in the *Papenprogramm* of 1932 and the *Sofortprogramm* of January 1933, of 302 and 600 million marks respectively. The Nazis boosted the ante with the *Reinhardtprogramm* (July 1, 1933) of one billion marks. Exact figures on the gross amounts of deficit financing for public works and work relief during these first years of the Nazi regime are impossible to secure, or even to estimate, but some indication of the jump which took place in 1933 and 1934 is given by the figures on work relief administered by the Reichsanstalt itself (in the form of grants to local communities). In the fiscal year ended March 31, 1933, an average of 60,000 workers were employed on work relief projects of this nature. In the following two fiscal years respectively this figure increased to an average of 288,000 and 334,000 workers.[29]

At the same time that this work-relief, public-works, and rearmament program was initiated as one aspect of the attack on unemployment, another type of activity was started. For lack of a better term, this type of action may be termed the reduction of unemployment by concealment; and its *modus operandi* was the control of the labor market through the machinery of the Reichsanstalt. Some of the measures of this type which were progressively introduced from 1933 onwards may be described briefly to indicate their nature:

1. *Prohibition of migration into large cities.* In the summer of 1934 the Reichsanstalt, acting in accordance with authority conferred upon it in a new law governing placement, forbade the movement of workers into the cities of Berlin, Hamburg, and Bremen, and the territory of the Saar without the approval of its local offices. Unemployment in these cities was particularly heavy, and it was difficult to reduce it because the attraction of life in the large cities produced a continuous influx of people from the rural and agricultural areas. This measure may or may not have reduced unemployment, depending upon whether there was actually a real shortage of farm labor, but the presumption is that it was a measure designed to keep the farm youths on the farm and prevent them from swelling the obvious unemployment in the large cities.[30]

2. *Limitations on the transfer from agricultural to industrial employment.* In May 1935 a regulation was promulgated by the Reichsanstalt making it compulsory for all persons employed in agriculture as of that

[29] Anton Grohe, *Die Finanzierung der Arbeitslosenhilfe* (Berlin, 1937), p. 69.

[30] *Anordnung über die Regelung des Arbeitseinsatzes in den Stadtgemeinden Hamburg, Altona, Wandsbek, und Harburg-Wilhelmsburg*, 8/30/34, *Reichsgesetzblatt*, pt. I, p. 205 (1934).

date (or during the previous three years) to get the approval of a local office of the Reichsanstalt in order to take employment in any one of the following list of industries: mining, iron and steel, smelting, building and construction, brickmaking, railroad and railroad construction, repair and maintenance, and with the post office (which included the telephone, telegraph, and bus services). For women the number of such listed industries was considerably larger. This regulation was suspended a couple of years later when the situation had materially improved so far as unemployment was concerned, but the intent of the order at the time is very apparent, to limit the influx into trades in which unemployment was particularly severe and to keep the surplus agricultural population on the farm, where there may not have been enough work to do, but where there was at least enough to eat and the state was not required to furnish relief.[31]

3. *Placement of the younger unemployed in agriculture.* In the years 1935 and 1936 from 100,000 to 170,000 unemployed under the age of twenty-five were given agricultural employment with farmers for six months or a year. Part of the wage was supplied in the form of a subsidy to the farmer by the Federal Institution, but the farmer bore the entire cost of board and lodging. But in order to get the necessary number of young people to enter this rather unattractive occupation, it was necessary to introduce the following control: [32]

4. *Regulation of the number of employees under twenty-five years of age in each industrial and commercial establishment.* In the summer of 1934 a regulation was issued requiring each employer to submit to inspection by the local office of the Federal Institution the age distribution of his staff in order to encourage the employment of older men. There were no definite percentages set forth in the regulation, but each case was left up to negotiation between the employer and the local labor office. However, the maneuver was successful to the extent that some 130,000 unskilled workers under the age of twenty-five were replaced by older men and women. The displaced younger workers were then steered as far as possible into the army, the work camps (*Arbeitsdienst*) and agricultural employment. An additional requirement was the approval of the local office of the Reichsanstalt for the hiring of any person under the age of twenty-five years. The obvious intent of this move was the same as the previous measure, to force the displacement of younger workers by older men and heads of families who were on unemployment relief. The younger persons could either be absorbed elsewhere or live on their parents, thus reducing the obvious and immediately apparent volume of unemployment.[33]

[31] *Siebenter Bericht der Reichsanstalt, 1934–1935* (Berlin, 1935), p. 20.

[32] *Ibid.*, p. 23.

[33] *Anordnung über die Verteilung von Arbeitskräften*, 8/23/34, *Reichsarbeitsblatt*, pt. I, p. 202; *Siebenter Bericht der Reichsanstalt*, pp. 17ff.

5. *The transformation of the work camps (Arbeitsdienst) from a voluntary to a compulsory service.* In May 1933 the Arbeitsdienst, which had previously been under the jurisdiction of the Reichsanstalt as a voluntary service very similar to the American CCC camps (with the exception that salaries were not paid to the participants for the relief of their parents), was transformed into a compulsory six-months' service, prior to regular compulsory military training, and the number of young men enrolled was greatly increased.

What was common to all these programs was the fact that they were not direct attacks on unemployment through the creation of jobs in private industry, or even the provision of jobs on public works or work relief projects. Instead they were measures designed to reduce the obvious unemployment in the cities and certain industries and certain age groups by a restriction of the movement of individuals, forcing them into a position in which others would support them or in which their unemployment would be neither so costly to the state nor so apparent. The means of exerting this control over personal freedom of movement was the widespread and very effective machinery of the Reichsanstalt. Orders could be drafted at headquarters one day, and announced in the *Reichsgesetzblatt* and issued to the regional and local offices the next day. The personnel of the Reichsanstalt was thoroughly trained in administrative procedures, and could take over the duties involved in a new set of instructions and forms with a minimum of delay and friction. The experience of the Reichsanstalt with these measures, and the success with which it administered them, was undoubtedly responsible for the selection of the institution for the carrying out of a further group of controls with a considerably different purpose and orientation in the period which followed.

PLANNED CONTROL OF THE LABOR MARKET

The date on which the Nazi control of the labor market changed from a program designed to make unemployment less obtrusive, and less costly, to a scheme whose purpose was to distribute labor resources in accordance with the objectives of a directed or "planned" economy cannot be determined with any precision. Indeed, in the very nature of the situation this shift had to be a gradual one. It was not until heavy government expenditures had begun to have a noticeable effect in reducing unemployment that the formulators of policy could begin to think in terms of a positive pro-

gram; and it was really not until an actual shortage of skilled workers in certain occupations became apparent that labor market controls of another sort were introduced. Perhaps the best date to choose is October 18, 1936, when the Four-Year Plan for making Germany economically self-sufficient was announced. Even before this date, however, someone must have been doing some thinking along these lines, because almost two years earlier the introduction of the workbook, or labor passport (*Arbeitsbuch*), was begun.[34]

The workbook is not in itself a labor market control but a device for implementing and enforcing such controls. The basic statute on the workbook dates from February 26, 1935, but the issuing of the books was undertaken in several stages for different industries and categories of workers. In general, all wage workers receiving less than 1,000 marks per month who are above the age of compulsory schooling must have a workbook issued by one of the local offices of the Reichsanstalt. The book contains the worker's permanent file and identification number, occupational classification, age, family status, number of children, nationality, address, occupational history, special skills, and a variety of other information. The bulkiest part of the pocket-size book consists of blank pages in which the work and employment history of the individual is kept currently up to date. No employer is permitted to employ a worker who does not have such a book; and each time a worker is hired or fired, or changes his employment status in any way, this fact must be recorded in the book. In addition, duplicate file cards for each book are kept in the local offices of the Reichsanstalt. Workers are required to report to these offices for transcription into the book itself, and into the file card, changes in personal status, such as change in address or the birth of an additional child; and employers are required to report directly to local offices any changes in employment status, in addition to making the proper notation in the book.

It can be seen even from this brief description of the workbook what a powerful device it is and what a multitude of purposes it may serve. The requirement of producing the book to secure employment gives the Reichsanstalt the means of enforcing almost any kind of restriction or control, either over the individual worker or over any group or occupational classification of workers. If it is desired to draft workers with agricultural experience to take care

[34] *Gesetz über die Einführing des Arbeitsbuches*, in *Reichsgesetzblatt*, pt. I, p. 311 (1935).

of a temporary emergency in the harvesting of sugar beets, for example, word need merely be sent to the local offices in the area to comb through their files, select all the workers with this experience, and requisition them from employers in the neighborhood. If a shortage of carpenters exists, men with this experience who are working in other types of employment can be ordered to report for jobs as carpenters; if they balk at obeying the order, their workbooks (and therefore their means of livelihood) can be withdrawn.

The military uses of this device are equally apparent. One of the greatest difficulties encountered in the prosecution of the war, both by the Allied and the Central Powers, was the allocation of man power between the fighting forces and the production of munitions and other necessary goods and services. Modern warfare requires the most effective use of the entire resources of a nation, and without some systematic planning, an already existing card catalogue of the labor force of the country, and a nation-wide machinery for allocating this labor force, breakdowns either in the field or in the production of munitions are inevitable. Humbert Wolfe [35] has given a detailed description of these difficulties in Great Britain during the World War; and, though the story has not been told so fully for other countries, their problems were essentially the same. Without careful allocation — and such allocation is not possible without a good record of the occupational skills and abilities of the working population — the military forces will draw off into the field the very men who are most necessary to the enormous production of munitions which a modern war requires. The employment services of all western countries would be able to prevent a repetition of the worst fiascos of the World War, but their records are far less complete and useful than the workbook files of the Reichsanstalt. With the experience of the World War to draw upon, the German military command would be able to give orders not to accept for active service any workers in a long list of industrial classifications, as codified in the workbooks. Conversely, if men with certain technical skills, such as engineers or telephone technicians, were required for military operations, they could be produced within a couple of days by searching the files of the local offices of the Reichsanstalt.[36]

[35] *Labour Supply and Regulation.*

[36] The potentialities of the workbook for military and wartime uses has not been overlooked in Germany, and indeed may have been one of the chief reasons for its

The issuing of workbooks, which started in June 1935, was an enormous job. Even by taking one occupational group after another, the work was not substantially completed until about October or November 1936. By that time over twenty million books had been filled out, and only one or two million more were anticipated.[37] The Four-Year Plan, which was to require a great increase in the number of labor market controls, was thus put into operation just about the time that the workbook became usable as an administrative device. Before launching into a description of the regulations issued under the Four-Year Plan, it might be well to touch upon the changed economic situation which underlay these new controls.

BACKGROUND OF THE CONTROLS UNDER THE FOUR-YEAR PLAN

The high point of unemployment in Germany was in February 1933, with over six million registered unemployed. Unemployment is more seasonal there than in the United States, and each winter witnesses a great increase. But in January 1935 the winter peak had been reduced to less than three million and in September 1936, at the summer low point, it had dropped to slightly over one million.[38] But this figure of one million total unemployment gives a misleading and inaccurate picture of the labor market at that time. A large percentage of this total was composed of older men and others who were not fully "employable." More specifically, a distinct shortage of skilled workers was beginning to be felt, particularly skilled building workers and metalworkers.[39] Even special efforts on the part of the Reichsanstalt to secure workers of this type from areas like Saxony and the Rhineland, in which unemployment was still severe, failed to meet the demand. The combination of a vast increase in the manufacture of armaments and other materials for military use and the revival of the other parts of the economy which was induced by these expendi-

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introduction. See the discussion in Dr. Friedrich Syrup, *Arbeitseinsatz und Arbeitslosenhilfe in Deutschland* (Berlin, 1936), and Dr. Paul Ruprecht, "Facharbeiter und Kriegsführung," *Militair-Wochenblatt*, vol. CXXI, Nr. 9 (September 4, 1936), p. 438.

[37] *Neunter Bericht der Reichsanstalt, 1936–37*, p. 28.

[38] *Ibid.*, p. 5.

[39] The German term is *Metallarbeiter*, and includes such occupational groups as welders, boilermakers, machinists, and molders. Rather than use the term "machinist," which would be misleading, the word "metalworker" will be used, even though it is not in English usage in all these senses.

tures and those for public works was beginning to produce a situation in which continued government activity could no longer bring idle material and human resources into use but which would result in government and business bidding against each other for scarce supplies.

This was the situation in the period just prior to the announcement of the Four-Year Plan by the Führer and Reichskanzler at Berchtesgaden on October 18, 1936.[40] The announced purpose of the plan was to make Germany "entirely independent of all foreign materials which by any means could be produced through (her) chemical industry, machine industry, or mines." [41] General Göring was placed in charge of the plan and given complete authority to make use of any governmental or party agency in carrying it out. It was contemplated from the first that an integral part of this plan would be the control and regulation of the labor supply so as to make maximum use of it as well as of the physical resources of the country. The nature of this half of the scheme became apparent immediately after the publication of the formal order initiating the scheme and the appointment of Göring. Early in November Göring issued the first six regulations with respect to the labor market, and a seventh was added in December. All of them were entrusted to the Reichsanstalt for execution.

A summary of these first seven orders follows:

Order No. 1: Compulsory Apprentice Training

"One of the most important considerations in the carrying out of the Four-Year Plan is the safeguarding of the development of skilled workers. That is particularly true for the iron and steel and metalworking industries, and for the construction industry. It is the duty of all private and public enterprises in this connection to take part in the training of such workers."

To carry out these purposes, the order required each employer or enterprise in the iron and steel, metalworking, and construction industries with ten or more employees to report to the proper local office of the Reichsanstalt the number of apprentices employed. The local office would then inform the enterprise of the number that should be employed, and if the employer was not willing to take on this many, he was held responsible for reaching an agreement with the local office for the payment

[40] *Verordnung zur Durchführung des Vierjahresplans*, in *Reichsgesetzblatt*, pt. I, p. 887 (1936).

[41] Adolf Hitler, Nuremberg, September 1936, quoted in *Der Arbeitseinsatz im Vierjahresplan*, by Friedrich Syrup (Berlin, 1937), p. 7.

of a certain sum to enable the Reichsanstalt to do a similar amount of apprentice training.[42]

Order No. 2: Control of Employment in the Metal and Metalworking Industries

In order to allot the short supply of skilled workers, after December 1, 1938, enterprises in the iron, nonferrous metals, smelting, structural ironwork, machine, railroad equipment, airplane, electric, optical, welding, and metal-ware industries were required to get permission of the local office of the Reichsanstalt for an increase of skilled workers of more than 10 per cent above the number employed on the first day of the quarter. The local office was empowered to grant in whole or in part, or to deny, such requests in the light of economic and political (*staatspolitisch*) considerations, particularly the considerations of rearmament, development of the production of domestic raw materials, production of food, the stimulation of export trade, and the development of housing for workers.[43]

Order No. 3: Recall of Skilled Metalworkers and Building Workers into these Occupations

In order to ease the shortage of these types of workers, employers employing skilled metalworkers and building workers for more than two weeks on other types of work were required as of December 1, 1936, to notify the proper local office of the Reichsanstalt of this fact on official forms. The local office was empowered then to discuss with the employer the placing of these workers on work for which their training and abilities fitted them, and if the employer was not willing to make this change, to transfer them to such employment elsewhere.[44]

Order No. 4: Control of the Number of Workers and the Amount of Raw Material Used in Construction Projects

This order is particularly interesting because it marks the first use of the nation-wide network of the Reichsanstalt for economic controls not having to do with the labor market. For all construction jobs involving two tons of iron or more, contractors were required as of November 7, 1936, to notify the local office of the Reichsanstalt, at least four weeks before the beginning of actual construction work, of the number of skilled workers of various types and the amount of materials of various

[42] *Erste Anordnung zur Durchführung des Vierjahresplans über die Sicherstellung des Facharbeiternachwuchs*, 11/7/36, *Deutscher Reichsanzeiger*, Nr. 262 (1936).

[43] *Zweite Anordnung zur Durchführung des Vierjahresplans über die Sicherstellung des Bedarfs an Metallarbeitern für Staats- und wirtschaftspolitisch bedeutsame Aufträge der Eisen- und Metallwirtschaft*, 11/7/36, *ibid.*

[44] *Dritte Anordnung zur Durchführung des Vierjahresplans über die Rückführung von Metallarbeitern und Baufacharbeitern in ihren Beruf*, 11/7/36, *ibid.*

descriptions which would be needed. Depending upon the size of the job, the local, regional, or headquarters office of the Reichsanstalt would then determine whether the numbers of workers and amounts of materials requested should be granted in whole or in part. This was one of the first definite steps taken to allocate the use of the short supplies of iron and steel to uses which were in line with the objectives of the regime.[45]

Order No. 5: Enforced Employment of Elderly Clerical Workers

All establishments with more than ten clerical workers were required to inform the local offices of the Reichsanstalt prior to January 15, 1937, of the ages of clerical employees employed on January 4; and the local offices were empowered to require the employment of more clerical employees over the age of forty if they thought that the proportion of older to younger employees was too low.

In one sense this type of measure harks back to the policy which was pursued when unemployment was still heavy; but in another sense it is entirely consistent with the other Four-Year Plan measures instituted at this time. Older clerical employees, of which there were still about a hundred and fifty thousand,[46] could not easily be retrained for other work; and in order to make maximum use of the labor force of the nation it was expedient to push them back into clerical jobs and use the younger clerical workers who were thus released in any number of occupations for which their youth made them adaptable.[47]

Order No. 6: Prohibition of Box-Number Advertisements for Skilled Metalworkers and Building Workers

Such advertisements in newspapers or magazines or circulated lists were forbidden from November 7, 1936, onwards without special permission of the president of the Reichsanstalt, which permission would in actual practice rarely, if ever, be given.[48]

Order No. 7: Permission to Employers to Reduce Labor Turnover by Withholding the Workbooks of Employees Quitting without Notice

In order to reduce labor turnover to the smallest possible amount and to discourage further the practice of one employer's bidding workers

[45] *Vierte Anordnung zur Durchführung des Vierjahresplans über die Sicherstellung der Arbeitskräfte und des Bedarfs an Baustoffen für staats- und wirtschaftspolitisch bedeutsame Bauvorhaben*, 11/7/36, *ibid.*

[46] *Neunter Berichte der Reichsanstalt, 1936–37*, p. 27.

[47] *Fünfte Anordnung zur Durchführung des Vierjahresplans über die Beschäftigung älterer Angestellter*, 11/7/36, *Deutscher Reichsanzeiger*, Nr. 262.

[48] *Sechste Anordnung zur Durchführung des Vierjahresplans über das Verbot von Kennwortanzeigen für die Anwerbung oder Vermittlung von Metallarbeitern und Baufacharbeitern*, 11/7/36, *ibid.*

away from another, employers in the building, metal, and brick industries and in agriculture were given permission to refuse to give back the workbooks of employees who quit without notice or broke contracts of employment after December 22, 1936, until the end of the period for which such notice or contract would have applied. A worker without a workbook could not, of course, legally secure any other paid employment.

It is significant to note the similarity between this procedure and the one which was in force in Great Britain during most of the World War period under the famous Section 7 of the Munitions of War Act, 1915.[49] Under that section employees on munitions work were required to get a leaving certificate from their last employer, and without this certificate they could not get employment elsewhere on munitions work. The workbook serves the same purpose as the leaving certificate; and it reflects the degree to which the labor control and regulation devices of present-day Germany are those of an economy on a war footing.[50]

Following this first group of orders by Göring, the output of additional labor market controls fell off a bit, but as the shortage of skilled labor continued in the metal and construction industries, and spread to other fields, increasingly vigorous measures were required from time to time. It will suffice here to sketch these steps briefly to indicate the general trend of development. A whole group of these measures consisted of extending to an increasing number of occupations the prohibition against the employment of new workers without the permission of the local offices of the Reichsanstalt. It should be mentioned that this type of action not only directed skilled workers into the armament plants and other places where they were needed but also helped to restrain the tendency for wages to creep up as employers bid against each other for men. There were strict laws against increases in wages, but it aided their enforcement to reduce as far as possible the competition of employers for workers.

The first of this further series of measures was an order of the president of the Reichsanstalt,[51] under power given by a 1934 order of Schacht as Reichswirtschaftminister.[52] This required that before skilled metalworkers could be hired the approval of

[49] Cf. pp. 253ff. above, and Humbert Wolfe, Chap. XII.

[50] *Siebente Anordnung zur Durchführung des Vierjahresplans über die Verhinderung rechtswidriger Lösung von Arbeitsverhältnisse*, 12/22/36, *Deutscher Reichsanzeiger*, Nr. 299 (1936).

[51] *Anordnung über den Arbeitseinsatz von Metallarbeitern*, 2/11/37, *Deutscher Reichsanzeiger*, Nr. 35 (1937).

[52] *Verordnung über die Verteilung von Arbeitskräften*, 8/10/34, *Reichsgesetzblatt*, pt. I, p. 786.

the local office of the Reichsanstalt in the district in which the worker had last worked must be secured. On April 27, 1937, this same limitation was extended to all employees in the chemical and construction industries in the local office areas of Halle, Bitterfeld, and Wittenberg in central Germany; and an additional enforcement technique of requiring all government agencies to inform the Reichsanstalt of any violations of the order was introduced.[53] In October 1937 this restriction on hiring was extended to bricklayers and carpenters, but, because of the tendency toward seasonal unemployment among these workers in the winter, it was softened a little to provide that the approval of the local office of the Reichsanstalt should not be necessary for hirings taking place between December 1 and February 28, nor when the worker's workbook indicated that he had been unemployed.[54] In December 1937 even the man power of migratory workers and pedlars was drawn into the net by a regulation of the president of the Reichsanstalt that licenses were not to be given to these two classes of persons if they could be used to reduce a labor shortage in other occupations.[55] This particular line of control may continue to be extended but the regulation of the president of the Reichsanstalt of March 1, 1938, marked a definitive step: it gave the presidents of the regional offices power to require any employer to get permission of his local office to hire any type of worker.[56]

As in the World War experience of many of the combatant countries, the point was reached early in 1938 at which the shortage of labor became so acute that it became necessary to begin drawing upon the great labor reserve of women. This was a considerable change from the earlier policy of the Nazis to get women out of paid employment, send them back to *Kinder*, *Küche*, *und Kirche*, and give their jobs to men; but the first step, at least. could be rationalized in terms of the need for getting people, especially young people, back into touch with the soil. Whatever

[53] *Anordnung über den Arbeitseinsatz von Arbeitern der Chemischen Industrie und des Baugewerbes in den Bezirken der Arbeitsämter Bitterfeld, Halle und Wittenberg*, 4/27/37, *Deutscher Reichsanzeiger*, Nr. 98 (1937).

[54] *Anordnung über den Arbeitseinsatz von Mauerern und Zimmererern*, 10/6/37, *Deutscher Reichsanzeiger*, Nr. 233 (1937).

[55] *Anordnung zur Durchführung des Vierjahresplans über Beschränkungen in der Ausübung des Wandergewerbes und Stadthausiergewerbes*, 12/14/37, *Deutscher Reichsanzeiger*, Nr. 269 (1937).

[56] *Anordnung zur Reglung des Arbeitseinsatzes in einzelnen Betreiben*, 3/1/38; *Deutscher Reichsanzeiger*, Nr. 51 (1938).

the rationalization, Göring issued an order on February 15, 1938, prohibiting the hiring of single women under twenty-five unless they had worked at least a year in agriculture or in domestic service. This blanket order was somewhat restricted by a supplementary regulation issued the next day by the president of the Reichsanstalt, permitting certain exceptions to this requirement.[57] Another regulation of still a different type, but also designed to ease the shortage of man power, was that issued on March 1, 1938, requiring all children leaving school to report to the local offices of the Reichsanstalt to fill out record cards and thus make themselves available for work.[58] When one takes into account the fact that probably some 95 per cent of the school-leavers had already been voluntarily reporting to the local offices of the Reichsanstalt for vocational guidance and jobs, it will be realized how wide the dragnet for additional workers was being drawn.[59]

SUMMARY AND CONCLUSIONS

This brief sketch of the development of the public employment services and labor market regulation in industrial countries in the last forty years indicates that a new technique and a new instrument of government has been built up — more or less haphazardly and without conscious purpose or objective, it is true — which may be put to many uses. We have seen how public employment services grew out of charitable activities and the attempt to relieve unemployment, how their military usefulness was discovered during the World War, how they have become in most major industrial countries an essential part of any comprehensive scheme of unemployment relief or insurance, and how in the last few years they have developed into one of the most essential organs of the dictatorship in Germany. This last use has not

[57] *Anordnung zur Durchführung des Vierjahresplans über den verstärkten Einsatz von weiblichen Arbeitskräften in der Land- und Hauswirtschaft*, 2/15/38; and *Durchführungs Anordnung zur Anordnung über den verstärkten Einsatz von weiblichen Arbeitskräften in der Land- und Hauswirtschaft*, 2/16/38; *Deutscher Reichsanzeiger*, Nr. 43 (1938).

[58] *Anordnung über die Meldung Schulentlassener*, 3/1/38; *Deutscher Reichsanzeiger*, Nr. 51 (1938).

[59] This account of individual labor control measures could be extended still further, but enough have been listed to give a clear indication of their nature and the extent to which they are being used. Along with this extension of measures designed to relieve the shortage of workers, there was, of course, a gradual elimination of the earlier measures which had been used in combating unemployment and lightening the burden of relief (pp. 264ff. *supra*; *Neunter Bericht der Reichsanstalt*, p. 26).

gone nearly so far in Russia and Italy as it has in Germany; and in Russia, at least, this failure to organize, control, train, and develop the labor force of the country has been one of the primary reasons for the difficulties the Soviets have had with their plans for the increase of industrial production under forced draft.[60]

Recognizing that, in the hands of dictators, this machinery can be used to limit the freedom of movement and other liberties of the populace in a manner which was impossible for ancient tyrannies because they did not have the administrative machinery and techniques to do it, nevertheless it should be appreciated that no democratic nation can afford to dismantle this machinery just because of the harmful uses to which it might be put. For one thing, in an age in which a comparatively large volume of unemployment seems to be a more or less permanent feature of economic life, it is essential that effective machinery should exist for handling this unemployment systematically. It is desirable, further, that the securing of employment be put on a rational and respectable basis, rather than be permitted to continue as an aimless and degrading process of tramping from place to place in search of work. It is equally desirable that the vocational education of young people and their induction into working life should be done systematically, by developing a vocational guidance service in the public employment office system, as has been done in England and in Germany. In this way young persons leaving school may be led into work which is suited to their temperaments and abilities, instead of finding it through the difficult trial and error process.

Last, and not of least importance at the present time, is the fact that no country can now afford not to have an effective national system of public employment offices. In any major modern war lasting more than a year a good employment service is worth any number of battleships, airplanes, or tanks. In fact, the effective production of these and other materials in time of war is very largely dependent upon a machinery to select the man power which can safely be used for the military forces themselves without crippling the production of munitions and the continuance of economic life on a much higher level of production than that which

[60] For example, labor turnover in many Russian plants is enormous, running to several hundred per cent in some. Recently, reports have reached the United States that a new series of regulations to reduce labor turnover have been introduced in the Soviet Union (*Business Week*, January 7, 1939, p. 39, cable dispatch). The details are not yet available, but the mechanics of the scheme seem to be a record of every worker and a system of labor offices.

obtains in peacetime. As a war progresses, this same machinery must be used to an increasing extent to make the most effective use of the existing labor force, and to recruit and train reserves of man power which are not normally used in peacetime.

Another aspect of this subject — much more difficult to discuss, even in hypothetical terms, because there is no historical or contemporaneous experience to draw upon — is the possible role of such public control and regulation of the labor market in a democratic nation in which governmental operation of economic enterprises and governmental control of business shall have been extended much further than it now has in any country of the world. (Without venturing into the field of prophecy, it is safe to say that the expansion of governmental activities will continue in the United States and other democratic western nations.) The question may be asked: Does not Sweden offer such an example of a democratic country in which government participation in economic life is very extensive? In this, as in other connections, the Swedish experience is not much help to a country like the United States, with three million square miles of territory and one hundred thirty million people. Sweden does have an effective system of public employment offices, but the country is so small and the economic life relatively so simple, that she could probably get along almost as well without one.

For the United States, however (and this is more or less in the nature of a digression, because the problem would be with us regardless of the form of economic organization), it can be predicted that the public employment service will become increasingly useful in guiding and facilitating the distribution of population. During the last few years the states of the industrial North and East have shown very little net increase in population. The South and West, on the other hand, have not shown such large declines in their net reproduction rates, and a sizable increase in population still takes place each year. If present population trends continue along the lines of even the most conservative estimates by population experts, we shall very soon reach the stage at which the population of the North and East will actually start declining, particularly in the cities, and a vast movement of population will be necessary to operate present productive facilities. (This assumes, of course, that industry will not move to the people but that the people will move to industry; the experience of the last twenty years indicates, however, that this assumption is a reason-

able one.) Despite the rapid industrialization of certain parts of the South since the World War, that industrialization has not kept pace with the increase of the population. As internal migration increases — and it must, if the standard of life in regions of increasing population is not to decline — it is desirable that migration be guided and handled as systematically as possible. It is certainly better that the public employment service should bring people from North Carolina and Georgia to Michigan or New York for definite jobs for which they are fitted than that they should drift aimlessly north in search of any kind of work.

But let us return, after this rather long digression, to examine the role of an employment service in a democratic country in which governmental activities have expanded much further into the economic sphere than they have in the United States at the present time. Such expansion of government activity would in all probability be accompanied by an extension of a civil service or merit system for the selection of personnel, and a corresponding diminution of the placement activities of legislators and other politicians. As the government took over more operating functions, such as the T.V.A., a larger proportion of government employees would be manual workers. Probably the public employment service would then be consolidated in large measure with what is now the entirely separate system of selecting government employees. This actually happened in Germany after the World War. Higher officials (*Beamten*) continued to be selected in a special manner, but the vast majority of the employees recruited for state enterprises like the railroads, and even for ordinary government functions, were selected from among the people registered at the local offices of the Reichsanstalt. This has also occurred to some extent in England. In times of heavy unemployment, when additional clerks have been required to compute and pay unemployment insurance benefits, the Ministry of Labor has taken on temporary employees from among the persons registered at the local employment exchanges.

Still another development (and this is rather an ominous thought) might be the use of this machinery to control and restrict the freedom of movement and choice of the individual, a freedom that is now limited only by personal ties and impersonal economic restrictions. This, of course, depends upon the direction which increased governmental control takes. If it takes the form of the control of prices, it is extremely likely that the control of wages

will follow. And the control of wages may be impossible to enforce unless employers can be prevented from bidding against one another for employees. If this sequence develops, it is entirely possible that restrictions of the right to leave work may be introduced, as they were in England during the World War with the leaving-certificate scheme, and as they have been under the Four-Year Plan in Germany through the use of the workbook.

SOCIAL SCIENTISTS IN THE FEDERAL SERVICE

Lewis B. Sims

WITH the downswing of the business cycle in 1929, business and private initiative everywhere turned to publicly administered machinery to pull the economy out of the doldrums. This phenomenon was not peculiar to the United States; the depression and the subsequent dependence upon government occurred in Germany, England, France, Austria, and other countries. The world has become government-conscious. This increased demand for governmental activity, especially central governmental activity, did not arise only in 1929, although it was accelerated at that time. For decades the governments of many of the more progressive countries had been regulating business, inaugurating social insurance schemes, taking over economic enterprises, and in general enlarging the scope of their activities — all at the request of the citizenry.

Increased activity requires increased man power. In the United States, for example, the number of federal employees (in the executive civil branch only) increased over 220 per cent from 1910 to 1938, while the population increased less than 135 per cent. This is indicated in Table 1. Moreover, a similar growth in the number of public employees has taken place in other countries. The exact figures, however, are extremely difficult to obtain even for relatively recent years and almost impossible to secure for the earlier years. In any event, the statistics that are available are not at all comparable. A noble attempt has been made by Herman Finer to compile these data in an intelligible form, but they must be used with the utmost caution.[1] A second attempt has recently been made by Walter R. Sharp, but he too has found it impossible to secure comparable data.[2] Despite the paucity of reliable statistical data, the evidence is clear enough to

[1] *The Theory and Practice of Modern Government* (New York: The Dial Press, 1932), II, 1167.

[2] See his article, "Public Employment," *Encyclopedia of the Social Sciences*, XII, 628–637. Sharp's data are as of various years, but for each country they are for one of the early years of the 1929 depression. Comparable statistics reflecting the growth of public services during the depression itself simply are unobtainable.

TABLE 1

POSITIONS IN THE EXECUTIVE CIVIL SERVICE OF THE UNITED STATES GOVERNMENT IN SELECTED YEARS, 1883–1938

Fiscal year	Number of Positions [a]	U. S. population (estimated) [b]
1883 [c]	131,208	54,420,000
1889	159,356	60,389,000
1894	180,000	67,297,000
1900	208,000	74,689,889 [d]
1904	301,000	81,329,422
1910	370,000	90,374,497 [d]
1914	435,000	96,551,717
1919	917,760	102,962,949
1924	554,986	112,078,611
1926	528,542	116,532,000
1927	527,228	118,197,000
1928	540,867	119,862,000
1929	559,579	121,526,000
1930	580,494	122,775,046 [d]
1931	588,206	124,113,000
1932	583,196	124,974,000
1933	572,091 [e]	125,770,000
1934	673,095	126,626,000
1935	719,440	127,521,000
1936	824,259	128,429,000
1937	841,664	129,257,000
1938	851,926	130,215,000

[a] The employment data for 1926 and the years since 1926 are from the U. S. Civil Service Commission, *Annual Report*, 1938, Table 5. The earlier figures are from Darrell H. Smith, *The United States Civil Service Commission*, Institute for Government Research, Service Monograph No. 49 (Baltimore: The Johns Hopkins Press, 1928), p. 37. Both the classified and the unclassified employees are included.

[b] The population estimates since 1930 are from Bureau of the Census, *Estimated Population of Continental United States and Outlying Territories and Possessions as of July 1, 1938* (Nov. 16, 1938), 3 pp.

[c] Jan. 16, 1883 to Jan. 15, 1884.

[d] Decennial census figures.

[e] 70 per cent of this decrease is accounted for by a reduction in the postal service.

support the point that in almost all countries the magnitude of the public personnel problem, and hence of the recruitment problem, is prodigious, especially as compared with a short time ago.

One of the greatest causes of this increased public personnel is

government's incursion into the social and economic field.[3] This phenomenon is too well known to require elaboration here. But what has happened as a result? *A new type of public employee has been demanded.* This demand is more noticeable in the United States than in foreign countries and more in the federal government than in state and local governments. However, the trend toward increased demand for this new type of public employee is clear in almost all countries and on both the national and the local levels. This new type of employee is what we may call generically the "social scientist."

The term "social scientist" is not merely a high-sounding label for a politico or for a general handy man.[4] Nor is it a title given to a man who is generally intelligent and interested in things social and economic. By a social scientist I mean a person who is professionally, technically, and academically trained in one or more of the social sciences. The absolute minimum of educational preparation acceptable under such a definition is the completion of a four-year course in an accredited institution of higher learning, with major or concentration in one or a combination of the social sciences. That is to say, a social scientist is very definitely a professional, scientific, or technical person, in no sense the "amateur," as we have come to use that term in connection with the so-called administrative class of civil servants in the British bureaucracy.[5]

[3] One of the best discussions of this subject is C. C. Rohlfing *et al.*, *Business and Government* (Chicago: The Foundation Press, 3rd ed., 1938). The "public business man" is proposed in A. N. Holcombe, *Government in a Planned Democracy* (New York: W. W. Norton, 1935). For a scorching criticism of expansion of the federal government, as of 1933, see James M. Beck, *Our Wonderland of Bureaucracy* (New York: Macmillan, rev. ed., 1933), esp. Chapter VI, entitled "The Mushroom Growth of Bureaucracy."

[4] In 1937, after the United States Civil Service Commission had announced its examinations for Social Science Analysts, one person addressed a two-page typewritten letter to the President of the United States accusing the President of fostering the appointment of WPA pay-rollers and other alleged unworthies to salaried federal positions under the pretense that "scientific" people are needed. A "Social Science Analyst," it was contended, could not possibly exist!

[5] The term "bureaucracy" is often used in a sinister way, as in the first paragraph of Harold Laski's "Bureaucracy," in the *Encyclopedia of the Social Sciences*; Beck, *Our Wonderland of Bureaucracy*; Lucius Wilmerding, *Government by Merit* (New York: McGraw-Hill, 1935); Robert Von Mohl, *Staatsrecht, Völkerrecht, und Politik*, vol. II (Tübingen, 1860–1869); and the various writings of the United States Chamber of Commerce. The word "bureaucracy" is more appropriately used by Ramsay Muir, *Peers and Bureaucrats* (London, 1910); C. J. Friedrich and Taylor Cole, *Responsible Bureaucracy: A Study of the Swiss Civil Service* (Cambridge, 1932); Georg Jellinek, *Allgemeine Staatslehre* (Berlin: O. Häring 1900); Max Weber, *Wirtschaft und Gesellschaft* (Tübingen: J. C. B. Mohr, 1925); William E. Mosher

In order to present a picture of the role of professional social scientists in the federal civil service, it may be well to set down briefly the federal agencies that employ social scientists.

As a starting point, let us take the agencies specifically mentioned in the announcement of the Social Science Analyst examinations made by the United States Civil Service Commission on March 15, 1937. These agencies are possibly the leading ones employing social scientists under civil service recruiting procedure:

Social Security Board
Bureau of Agricultural Economics
Commodity Exchange Administration
Bureau of Labor Statistics
Children's Bureau
Bureau of the Census
Bureau of Foreign and Domestic Commerce
Central Statistical Board
Agricultural Adjustment Administration
Securities and Exchange Commission
Interstate Commerce Commission
Division of Research and Statistics in the Treasury Department
Bureau of Mines

To this list should now be added certain other agencies, notably the Wage and Hour Division in the Department of Labor, the Treasury Department's divisions of Tax Research and Monetary Research, and the National Labor Relations Board.

The opportunity for social scientists, primarily for economists, social service researchers, and statisticians, has broadened remarkably within the past few years. The number of social science positions probably doubled during the two calendar years 1935 and 1936,[6] and from May 15, 1931, to December 1, 1937, the number increased from 683 to 2,156.[7] The new positions in the

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and J. Donald Kingsley, *Public Personnel Administration* (New York: Harpers, 1936); Arnold Brecht, "Bureaucratic Sabotage," *Annals*, vol. 189 (January 1937), pp. 48–57; Marshall E. Dimock, *Modern Politics and Administration* (New York: American Book Company, 1937). Of bureaucracy, Dimock writes: "Expertness, professionalization, teamwork, hierarchical authority — these are the earmarks of bureaucracy" (p. 391).

[6] Leonard D. White, "New Opportunities for Economists and Statisticians in Federal Employment," *American Economic Review*, vol. XXVII, no. 1, Supplement, March 1937, p. 211.

[7] Charles H. Judd, "Summary of Memoranda on Research of the Federal Government in the Social Sciences," in *Research — A National Resource*, report of the Science Committee to the National Resources Committee (November 1938; released

classified civil service are found principally in the Department of Agriculture, the Department of Labor, the Social Security Board, the Railroad Retirement Board, the Securities and Exchange Commission, the National Labor Relations Board, the Tariff Commission, the Interstate Commerce Commission, the Bureau of the Census, and the Central Statistical Board. As might be expected, the amount spent by the federal government for social science research likewise is increasing. According to a recent study by Edward R. Gray, federal expenditures for researches in the social sciences and statistics increased from seventeen million dollars in 1937 to nineteen million dollars in 1938, the latter amount accounting for 24 per cent of the federal expenditures for research from regular funds in 1938.[8]

A number of "emergency" agencies also employ social scientists, but they do not come within the purview of this essay, for the employees of such agencies ordinarily are not under the classified civil service. A few of them are the Works Progress Administration, the Public Works Administration, the National Resources Committee, the Federal Housing Administration, and certain of the government-owned corporations, as, for example, the Reconstruction Finance Corporation, the Home Owners' Loan Corporation, and the Tennessee Valley Authority.[9] Two-thirds of the federal expenditures for research made from emergency funds are in the social science fields and statistics.[10]

It is impossible to say exactly how many federal agencies utilize the services of professional social scientists, for there is no generally accepted definition of an "agency" or of what constitutes the "utilization" of social scientists. Some indication, however, may be gained by the fact that, according to a 1937 count by the Central Statistical Board, there were ninety-eight federal agencies performing some sort of statistical work. An "agency" was defined as an independent board or commission or a bureau of a

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January 23, 1939), p. 49, Table 1. On May 15, 1931, the social science positions constituted 8.75 per cent of the professional and scientific service; by December 1, 1937, they constituted 17.28 per cent (*ibid.*).

[8] "Federal Expenditures for Research, 1937 and 1938," in report to the National Resources Committee cited above, p. 69, Tables 7 and 8.

[9] The Tennessee Valley Authority is not at this writing (January 1939) under "civil service," but it has worked out its own merit system, and in an elaborate way. By far the most thorough and comprehensive discussion of this system is a doctoral dissertation completed in April 1938, Ward Stewart, "Personnel Administration in the Tennessee Valley Authority" (unpublished), Harvard University.

[10] Gray, *loc. cit.*

department (except that each division in the Bureau of the Census and the Bureau of Labor Statistics was counted as an agency); agencies within and outside the classified civil service were included. Most of these statistical agencies employ professional social scientists.[11]

ECONOMICS AND STATISTICS IN THE FEDERAL SERVICE

One economist in Washington recently said, "The Federal Government is the economist's heaven." Of course, economists were not always so numerous in the federal service as they are today; nor were the opportunities for economists in federal employment so great a few years back as they are now. Economists were few in Washington until the administration of Theodore Roosevelt. In an analysis of employment by the United States Civil Service Commission in 1896 [12] not a single "economist" was listed. Leonard D. White's examination of this analysis has led him to say that "the word 'economic' occurs only once in these 499 pages, in reference to an 'economic ornithologist.' " [13]

Many of the economists in the federal service are labeled "statisticians." With the exception of a small percentage, most federal statisticians are economists. Hence it is convenient to discuss economists and statisticians as though they constituted a single group. Some inaccuracy is involved because of the use of the term "economist." Wilhelm Roscher, in his *Geschichte der National-Oekonomik in Deutschland*,[14] lumps legalists, political philosophers, historical philosophers, metaphysicians, and cameralists together and calls them all "economists." In the manner of Roscher, the United States Civil Service Commission today places the label of "economist" not only upon the professional student of economics but also upon the sociologist, the political scientist, the tax researcher, the public health expert (in some cases), and the expert in social service and public welfare. Within the last dec-

[11] Agencies of the federal government and the fields in which they collect or compile recurrent statistical data are listed in the report of the Social Science Research Council's Committee on Government Statistics and Information Services, which is entitled *Government Statistics*, Social Science Research Council Bulletin 26 (New York: April 1937), Appendix A.

[12] United States Civil Service Commission, *Tables Showing the Number of Positions in the Executive Civil Service of the United States on June 30, 1896* (Washington: Government Printing Office, 1897).

[13] "New Opportunities for Economists and Statisticians in Federal Employment," *American Economic Review*, vol. XXVII, no. 1, Supplement, March 1937, p. 210.

[14] München: R. Oldenbourg, 1874.

ade the title of "social economist" has been invoked to apply to certain of the non-economic types of economist. Thus, the term "economist" in the federal civil service is almost, although not quite, synonymous with the term "social scientist" as employed in this essay.

Table 2 shows the number of economics and statistics positions in the classified civil service for 1931, 1937, and 1939,[15] the figures being limited to the "departmental" positions.[16] From this

TABLE 2

CLASSIFIED POSITIONS IN ECONOMICS AND STATISTICS IN THE UNITED STATES GOVERNMENT IN SELECTED YEARS, 1931–1939[a]

Title of Series	May 15 1931	Dec. 1 1937	May 15 1939
Agricultural Economics Series	248	572	610
Business Economics Series	159	526	591
Forest Economics Series	7	14	17
Highway Economics Series	8	31	42
Home Economics Series	32	47	68
Social Economics Series	115	532	686
Statistical Series	79	392	473
Totals	648	2,114	2,487

[a] Unpublished data from the files of the Personnel Classification Division, U. S. Civil Service Commission.

table it will be seen that professional employment in the economic and statistical field has almost quadrupled in Washington in the past eight years; the index, based on 1931 as 100, is 326 for 1937 and 384 for 1939.[17]

Enough has been said to show the phenomenal growth of the economic and statistical services of the federal government. That the opportunities for highly qualified persons are great cannot be denied. Individual initiative and individual ability in the field

[15] It was not until 1931 that comprehensive data of this sort were made available by the U. S. Civil Service Commission. See Ismar Baruch, "Positions in the Professional and Scientific Service of the U. S. Government," *University Training for the National Service* (Minneapolis: University of Minnesota Press, 1932), pp. 50–105. The data for May 15, 1939, became available after the original submission of the present essay and were incorporated herein after galley proof had been received.

[16] That is, the data are exclusive of positions outside of the District of Columbia, and of course they do not include positions in federal agencies not under the Classification Act.

[17] Roughly one-sixth of the positions here under consideration are classified in grade P–6 and pay $5,600 or more a year.

of economics are and will continue to be recognized in the nation's permanent bureaucracy; real careers are now available.[18]

SOCIAL SERVICE RESEARCH: A NEW PROFESSION

So far as vocational training for the federal bureaucracy in the field of social service and welfare is concerned, the older universities in the United States are losing real opportunities for their students. Social service, on the research level, is now a full-fledged profession, and competent researchers are needed.[19] This is a field in which women have found a chance to enter upon a profession, with the result that comparatively few men have taken it up. The Social Security Board and the Children's Bureau (Department of Labor) are the best examples of agencies employing a large percentage of social service researchers. Like the economists, these "social economists," as they have been officially called, are highly and technically trained people, professionally prepared to do research. Thus far, a large percentage of these social scientists is recruited from the School of Social Service Administration of the University of Chicago and from the New York School of Social Work. The idea seems to be widespread, both among the general public and among placement officials in universities, that social service is the same as sociology. However, so far as vocational opportunities in the federal service are concerned, a sharp distinction should be made between the two. There are openings for the expert in social service, not many for the sociologist.

SOCIOLOGY IN THE FEDERAL SERVICE

The sociologist in Washington is regarded about as the political scientist is. His view is broad. He sees all of society as though from the mountain top. There are no jobs for him, or at least very few. The Division of Population of the Bureau of the Census, and the Farm Population and Rural Life Division of the Bureau of Agricultural Economics are the best examples of agencies employing sociologists — at that, only a few. Moreover, these

[18] See Isador Lubin, "Government Employment as a Professional Career in Economics," *American Economic Review*, vol. XXVII, no. 1, Supplement, March 1937, pp. 216–224.

[19] Cf. Esther Lucile Brown, *Social Work as a Profession* (New York: Russell Sage Foundation, rev. ed., 1936), and Elizabeth Cosgrove, "Selecting Social Workers for Federal Service," *Social Service Review*, XII, no. 3, September 1938, pp. 451–463.

sociologists must be statisticians as well. If there should be established a permanent national planning board under civil service regulations, as a general staff agency of the President, or if the works program were to be established on a civil service basis, a number of permanent positions for sociologists would appear.

Economic and social matters today constitute the most pressing problems of public policy in the national government. In such areas of governmental activity as monetary policy, taxation, transport, labor, social welfare, and agriculture a high order of skill and training is necessary for the effective formulation of national policy. Thus the federal service stands in constant need of qualified social scientists. Their role in national public policy bulks large, and for them there exists both a potential and an effective demand. Possibilities for early improvement in our social and economic services in the national government depend largely upon the recruitment of trained economists and social service researchers.[20]

POLITICAL SCIENTISTS AND FEDERAL EMPLOYMENT

Under present conditions there is hardly a position in the federal civil service that the professional political scientist per se can fill. It is almost inconceivable at the present time that an appoint-

[20] The improvement of the Prussian bureaucracy of the seventeenth and eighteenth centuries through the injection into it of *Cameralwissenschaft* was notable. A knowledge of cameralistics, or what we might call today "administrative economics" or "administration of fiscal policy," proved of great value to the Prussian officials from the standpoint of effective government. Indeed, such knowledge was essential to the proper functioning of the state, as then conceived. Familiarity with the social sciences, particularly *Cameralwissenschaft*, was, in seventeenth- and eighteenth-century Prussia, taken for granted. With the steady growth and the ever-increasing complexity of social and economic problems in the United States, it would seem advisable to recommend a favorable consideration of the earlier Prussian bureaucracy with a view to insisting upon the importance of highly qualified social scientists in the American national service. The most comprehensive analysis of eighteenth-century Prussia and her administrators trained in cameralistic theory is Albion W. Small, *The Cameralists: The Pioneers of German Social Polity* (Chicago: The University of Chicago Press, 1909). The best historical discussion of the Prussian administrative and economic system in the seventeenth and eighteenth centuries, from the general point of view, is Gustav Schmoller, *Umrisse und Untersuchungen zur Verfassungs-, Verwaltungs-, und Wirtschafts-geschichte besonders des Preussischen Staats im 17. und 18. Jahrhundert* (Leipzig: Duncker & Humblot, 1898). See especially Chapter V, "Der deutsche Beamtenstaat vom 16. bis 18. Jahrhundert," pp. 289–313. A good account in English is Walter L. Dorn, "The Prussian Bureaucracy in the Eighteenth Century," *Political Science Quarterly*, XLVI, 403–423 (September 1931), and XLVII, 75–94 (March 1932) and 259–273 (June 1932).

ing officer in one of the social or economic agencies in Washington should call upon the Civil Service Commission for a "political scientist." The scientific analyzer of purely political and governmental problems, it would be said, is not needed. Here is a real difference between the political scientist and the economist. The economist can do strictly economic research either in a university or in a federal agency, but the political scientist can do strictly political and governmental research only in a university, a bureau for municipal research, an institute of public administration, or the like. The political scientist, things being as they are, is precluded from selling his wares to the permanent federal bureaucracy.

Let us see why this is so. First of all, certain fields of political science are almost inherently academic and philosophical in character. They should not be expected to have direct vocational usefulness, despite their very great utility in the matter of mental training or of scientific political analysis. These fields are political theory, public opinion, and comparative government. The first two were even excluded from the written examinations held in 1937 for Junior and Assistant Social Science Analysts, for it was contended by the Civil Service Commission that it would be unwise to include in the examinations fields for which there probably would never be any demand from the operating agencies.[21] The field of comparative government, essential to an understanding of American political organization and processes, likewise has no vocational value in the federal social science service. The political science specialist in constitutional, administrative, or tax law has no vocational opportunities in Washington either; the lawyer is preferred. The student in the field of national government is indistinguishable from most alert federal employees. Engineers, chemists, economists — all soon become "political scientists" after a fashion, merely by living in Washington; everyone there thinks he knows the workings of the national government. There is no vocational demand for permanent professional experts in the field of national government. In the field of state and municipal government, the Census Bureau's Division of State and Local Government now seems to offer possibilities, but the total number of opportunities will be small.[22]

[21] For an extended account of these examinations, see my article, "The Social Science Analyst Examinations," *American Political Science Review*, vol. XXXIII, no. 3, June 1939, pp. 441–50.

[22] My view that there is little effective demand for political scientists in the

This is not to say that there are no political scientists holding social science research positions in the federal civil service. There are a few professional political scientists in Washington in the social science service. But they occupy their posts as economists. They are persons who have professionalized themselves sufficiently as economists to be capable of doing economic research work. They have learned, not only "government" but "the economics of government."

But what of public administration? Political scientists use the term "public administration" in a relatively narrow sense, meaning by it a field in the political science discipline. The term "public administration" also has a broader significance, for it may be used to encompass the entire activity of public authority. Thus at one and the same time we find at Harvard University, for example, the term "public administration" being used in both the narrow and the broad sense. "Public administration" is the title of a field in the Department of Government, and it is also the name of a graduate school in which fully half the emphasis is upon the economics of government. If the Graduate School of Public Administration were to carry its program to an extreme breadth, it would of course have to embrace most of the numerous professional schools at Harvard also.

Using public administration in the narrow sense, let us consider the role of the student of public administration in the federal social science service. What are his chances for employment? How can he serve in matters of national public policy?

At the present time the chances of employment are few, but the potential service that might be rendered is great. There is room in the federal service, as there is in the state bureaucracies, for people with ability to see the whole administrative picture. In any large-scale organization any one job tends to become routinized. The man with administrative vision and intellectual curiosity will be able to view the entire machinery of government, provided he has had proper preparation. It is unnecessary to labor this point, for it has become a commonplace among teachers, students, and practitioners in the field of public administration. If we are realistically to improve the administrative management of our national agencies of public policy, the role of the administrative

federal government is substantiated in Morris B. Lambie (ed.), *Training for the Public Service* (Chicago: Public Administration Service, 1935).

scientist should be recognized more widely than is the case at present.

There are also, of course, the "auxiliary staff" agencies,[23] in which administrative scientists are needed. At the present time men trained in public administration are not particularly desired. There are two reasons for this lack of demand. First, the administrative scientist is not at present appreciated in the budget, personnel, and purchasing agencies in the federal government. Second, university graduates purporting to be administrative scientists are now turned out by our universities like carpenters without their tools. More frequently than not, they have no grasp of accounting or statistics (essentials of the budgetary process) or of testing, classification, service ratings, etc. (essentials of the personnel management process). Neither have they sufficient knowledge of "organization engineering"—i.e., of administrative set-ups, of office management, of the flow of work in administration. A few of these technical subjects could profitably supplement the present broad training in public administration, though they should not supplant it. Contrary to the current notion, subjects like accounting, statistics, personnel management, and principles of organization and operation are not "picked up" on the job; they are legitimate subjects and should be accorded respect.[24]

The possibility of recruiting persons trained in public administration is only now being realized. Until the announcement of the Social Science Analyst examination in 1937 [25] there had never been an examination offered by the United States Civil Service Commission to which political scientists, per se, were eligible.[26] It is now hoped that appointing officers, when calling for a social

[23] See my essay, "The Meaning of Training for the Public Service," in *University Training for the Public Service* (Chicago: The Civil Service Assembly, Pamphlet 12, April 1938), pp. 26–29, especially the diagram and classification of public positions on pp. 26–27.

[24] Recently some new demand for persons trained in administrative procedures, "organization engineering," and public personnel has developed in certain agencies of the federal service, notably the Social Security Board and the Railroad Retirement Board. Since this essay was written, the Bureau of the Budget has set up a Division of Administrative Management with Donald C. Stone in charge; persons trained in public administration are already being asked for from the Civil Service Commission's register.

[25] See my article cited in note 21.

[26] The general examination for economists was announced by the United States Civil Service Commission on February 3, 1936. To this examination political scientists (and all other professional people) were eligible *if* they had the equivalent of an economics major at college.

science analyst from, for example, the labor relations register, will stipulate that the three persons certified by the Civil Service Commission must be equipped with a knowledge not only of labor relations but of public administration also.[27] Most appointing officers now at the helm in Washington are not likely so to stipulate, although there are a few who will. It apparently is up to the Civil Service Commission itself to "educate" the appointing officers regarding the value of recruiting economists and other social scientists familiar with the principles of public administration. At the 1937 conference of the American Political Science Association some interest was expressed concerning the then forthcoming social science analyst registers, particularly, of course, the public administration register, and the possibility of implementing the "educating" process was discussed.[28] It was pointed out at that time that, if the public administration register is not used, the Civil Service Commission will feel justified in omitting the public administration optional from future examinations in the social sciences. A year later (January 1939) it is possible to report that the public administration register has been used, principally by the Social Security Board, but that other political science registers have not been used at all.[29] From the standpoint of recruiting into the federal social science service a group of professional students of public administration (or of economics with public administration as a sideline), the Social Science Analyst examinations are especially significant.[30]

CONCLUSION

What kinds of career social scientists does the federal government need? And what kinds of training do the prospective federal social scientists need?

[27] This type of certification by the United States Civil Service Commission is called selective certification. See W. P. Lehman, "Selective Certification of Trainees," *Personnel Administration*, vol. I, no. 3, November 1938, pp. 4–6; and his "Federal Selective Certification," *Public Administration Review*, vol. I, no. 2, February 1939, pp. 5–8.

[28] With the passage of another year, however, interest in this question unfortunately had subsided almost to the zero mark. At the 1938 conference of the American Political Science Association there was little, if any, mention made either of the Social Science Analyst examinations in general or of the public administration register in particular.

[29] Two other registers touching upon political science have been used, namely, (1) public finance and fiscal administration and (2) government and business.

[30] One optional in the Junior Professional Assistant examination (given in the

First of all, even though one admits into the classification of social scientists the men with only a four-year collegiate preparation, four years is really not sufficient ordinarily to enable a man to acquire either the technical knowledge or the ability and keenness of mind now demanded by the federal social science service. There will be exceptional people capable of rising high on the ladder of achievement in the federal government with only the four-year background, and that is why the "absolute minimum" of higher education was placed at four years. But, on the whole, graduate work will be called for, either two or three years of it. Preferably the amount of graduate work should be increased to provide for the attainment of the Ph.D. degree.

Second, a reading knowledge of one foreign language and a rudimentary knowledge of another should be included in the recruiting requirements. Such a relaxation from the ordinary two-language requirement for the Ph.D. is practicable, since there is less use for foreign languages in government research than there is in academic research.

Third, every social scientist, without exception, should have a working knowledge of statistical method and an elementary knowledge of accounting. In academic circles it is hardly realized how current is the use of statistics and statistical method in the federal service. The well-trained social scientists should know more than the "elements" of statistics; a full year's work would, however, be sufficient. No social scientist in the federal service should have to be told the difference between a controlling account and a subsidiary account. Nor should he be unable — for lack of knowledge of accounting, anyway — to understand in a general way the Treasury Daily Statement.

With these three general requirements recorded, let us consider briefly the various kinds of social scientist in turn.

The Political Scientist: The pure political scientist, if he is looking for a career in the federal government, needs a new federal government! There is no place for him as such — or practically none. Unless his training includes work in public administration, economics, or social service research, he is not needed in the permanent bureaucracy. He may well be called in from the academic halls as an expert and paid on a per diem basis. But there

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spring of 1939 since the above was written) made provision for the recruitment of "junior administrative technicians."

seems to be very little need for the pure political scientist in the permanent social science service.[31]

The Public Administrative Scientist: The disparaging remarks in the above paragraph will be modified in this one. Public administration in the narrow sense is a part of political science. There is real need at the present time for properly trained administrative scientists, provided they are equipped with a knowledge of economic principles. Specifically, the student of public administration should acquire in the university knowledge of the usual subjects included in a year's course in public administration, and the ordinary subjects pursued as a political scientist. In addition, his program should include public finance (which should be considered as much a part of political science as of economics), economic theory, and preferably one additional field of economics. If all administrative scientists were equipped as here indicated, there would be little difficulty in persuading federal appointing officers to call for names from the Civil Service Commission's new "public administration" register.

The Economic Scientist: Two requirements only, in addition to his usual preparation, are needed by the economist in order better to fulfill the demands of the federal social science service. There are, first, a knowledge of public administration in the narrow sense (a semester's course might do) and, secondly, a healthy regard for the study of government as government, administration as administration.

The Social Service Scientist: The professional student of social service work needs the two requirements mentioned above in connection with the economist, but it would be desirable also for him to acquire an elementary knowledge of economic principles. Most researchers in social work do.

These, then, are the kinds of career social scientists the federal government needs, assuming, however, that this type of training has been supplemented with exercises in learning how to think systematically and how to look upon and use source materials with the proper amount of skepticism — in short, to borrow an expression of Louis Brownlow's, how to achieve "a perfect equipoise of respect and contempt."

[31] Almost the same may be said of the pure sociologist. However, since this essay was prepared, the two agencies mentioned in the section, "Sociology in the Federal Service" (*supra*), have appointed a good many sociologists. These two agencies are the Census Bureau's Division of Population and the Bureau of Agricultural Economics' Division of Farm Population and Rural Life.

One of the most hopeful signs in recent years, so far as the recruitment of federal social scientists is concerned, was the establishment in 1936 of the so-called "joint degree" in political economy and government at Harvard University. This degree is on the Ph.D. level and represents a recognition on the part of Harvard University of the need for more broadly trained social scientists in the American permanent bureaucracy. The counterpart of this departure is, of course, the announcement in 1937 of the United States Civil Service Commission's intention to recruit economic and other social scientists on a much broader scale than ever before. It is probable that students in Harvard's new Graduate School of Public Administration may, in considerable proportion, elect the "joint degree" in preference to the straight degree in either economics or political science.

There remains the question of the integration of the universities with the federal government. C. J. Friedrich has pointed out that it would be undesirable in the United States to formulate a federal plan of recruiting public personnel and "to attempt to realize that plan through a governmentally guided system of education." It would "run counter to the set political ways of this country." [32] It does not follow, however, that the federal government, through its Civil Service Commission, should not lay down the requirements for the personnel it needs. By doing just that, a sufficient amount of integration will automatically be effectuated.

In order to carry out the recommendations made in this article, it would seem essential to expand the present group of social scientists in the Professional Examining Section of the United States Civil Service Commission. Even as late as January 1939 this crew consisted of only four full-time members — three economists and a social service researcher.[33] During 1937–38 the membership consisted of two economists, a social service researcher, and a political scientist. This group should be enlarged sufficiently to permit not only the prompt rating of assembled and unassembled examinations but also the performance of a reasonable amount of steady analytical research into improved methods of recruiting social scientists for the federal service. Such an expanded scope of activity would necessitate only a very slight

[32] "Responsible Government Service Under the American Constitution," in Commission of Inquiry on Public Service Personnel, *Problems of the American Public Service* (New York: McGraw-Hill, 1935), pp. 1–74. The quotation is at p. 73.

[33] One other member of the Professional Examining Section is available part-time in the field of agricultural economics.

increase in appropriations for the Civil Service Commission. With the new and widespread attention accorded the problem of federal personnel, partially as a result of the President's Executive Orders of June 24, 1938, Congress has seen fit to enlarge the Commission's appropriations substantially. Thus, the Commission's expenditures in 1938 were $2,346,000; the estimated expenditures for the current fiscal year (1939) are $2,747,000; [34] and the President's 1940 budget calls for an appropriation of $4,400,000. There need be no hesitancy in putting forth the recommendation for a still greater appropriation, because the Civil Service Commission, like other auxiliary staff agencies in the federal government, and also like state and municipal civil service commissions, has traditionally been undermanned and underfinanced.

It is an important problem we have been considering here. With the coöperation of universities throughout the country, and with only a slight increase in appropriations for the United States Civil Service Commission, the federal government has it within its power to take a positive lead toward the recruitment of career social scientists. They are essential to the proper formulation, determination, and application of a sound public policy on a national scale.

[34] This figure includes a supplementary appropriation made in the Second Deficiency Bill, fiscal year 1938, amounting to $208,000, of which $58,000 was earmarked for new examiners in the Professional Examining Section. When the deficiency appropriation was received, it was planned to appoint four additional social scientists, one at $5,600, two at $3,800, and one at $2,000. After many months' delay these appointments were made. However, the vacancy left by the resignation of the examiner in public administration has not been filled.

SOME REFLECTIONS ON THE NATURE OF THE REGULATORY PROCESS

Merle Fainsod

"PROCESS" THEORY AS A TOOL OF ANALYSIS

IMPLICIT in the conception of regulation as process is the idea of movement and change, of society in flux, of interaction between individuals and groups, of adjustments and readjustments in their relationships. Regulatory experience is viewed in dynamic rather than static terms; the spotlight is focused on development and activity. As a tool of analysis, therefore, "process" theory serves to direct attention to the flow of relationships and the living forces which determine the character of regulatory activity.

A. F. Bentley's *Process of Government* furnished a vigorous pioneer example of this type of approach.

> When we talk about government [Bentley pointed out] we put emphasis on the influence, the pressure, that is being exerted by group upon group. . . . The balance of the group pressures is the existing state of society. . . . Law is activity, just as government is. . . . It is a group process, just as government is. It is a forming, a systematization, a struggle, an adaptation, of group interests. . . .[1]

The effect of this view is to accent the importance of the political energies which are stored in the individuals and groups that compose society. For if "the balance of the group pressures is the existing state of society," then to understand that society and the regulations which it fosters one must study the groups that make it up, their interests and their ambitions, their strength and their weakness, their combinations and their rivalries. Some interests may be powerful, others feeble; some may be active, others passive; some may be organized, others unorganized. The configuration of their interrelationships marks out the patterns and objectives of regulation. Government in this view can do little more than register the shifting balance of forces in the community; regulatory agencies become prizes in the struggle for power. That

[1] *The Process of Government* (Chicago, 1908), pp. 258, 259, 272.

interest or group of interests which captures control of them impresses its policy upon them. With realignments of power, a new conception of public policy is spelled out in terms of the claims of the new dominant combination. In so far as institutional arrangements exist which allow free play for shifts in the balance of forces, the pattern which emerges is essentially a dynamic or moving equilibrium. At any given moment, public policy is the resultant of a parallelogram of operative forces; the substance of public policy is redefined as the balance of power shifts. Government institutions thus tend to be transformed into mere pawns in a struggle for supremacy. Deprived of independent creative force, the purposes which they serve simply mirror the changing fortunes of battle. The energizing pressures of particularistic interests claim the center of the stage. The idea of public interest becomes a fiction used to describe an amalgam which is shaped and reshaped in the furnace of their conflicts.

This type of analysis has certain obvious attractions. It furnishes a useful antidote against undue absorption in the structures and forms of regulatory organization. It directs attention to the frequently neglected richness of group and sub-group energy which goes into the making of public policy. It visualizes the development of public policy as a dynamic product of interacting forces. The transfer of emphasis which results opens up fruitful lines of inquiry which have been overlooked in the past.

Yet there are shortcomings in the Bentley scheme of analysis which need to be pointed out. There is a danger that the inquiry will never get beyond the level of surface phenomena. To stress the actual play of group interests without examining the medium in which group interaction takes place or the underlying context of institutional arrangements out of which the interest groups themselves take shape, and within which they are compelled to function, is to leave the analysis of the regulatory process seriously incomplete. Pressure groups can become a dangerous obsession if the focus is merely on their activities, while the operative factors which inhibit or compel change and the basic determinants which dictate the possibilities of conflict and adjustment are only dimly apprehended.

The revolt against structure and form may easily go to an extreme. In dismissing all regulatory instruments as mere pawns in a struggle among interests, this analysis misses the possibilities of functional objectification inherent in the very development of

these instruments. In stressing the limits which environmental pressures impose on the uses to which these instruments are put, there is a tendency to underestimate the independent creative force and manipulative power which the wielders of these instruments acquire by virtue of their special competence or their strategic position in the regulatory hierarchy. The strategy by which regulatory agencies develop ability to resist or guide pressures has been relatively little explored. Yet it is obvious that, within limits, such power exists. The regulatory agency itself is capable of generating a certain amount of independent power to change its environment. The skill with which it is able to build on shared purposes or emergent communal aspirations will determine the success it enjoys.

THE INSTITUTIONAL SETTING FOR INDUSTRIAL REGULATION

These preliminary observations are by way of preface to the presentation of a scheme of analysis which, it is hoped, may avoid some of the deficiencies of the Bentley technique. Starting from the same general assumption as Bentley — namely, that regulation can best be understood as a process — the thesis is submitted that the nature of that process is most satisfactorily revealed when the analysis proceeds on three interrelated levels: (1) the conditioning factors which make up the institutional context of regulation, (2) the parties in interest who are concerned with the character of regulation, and (3) the actual political instruments which provide the pattern of operative controls.

The significance of the institutional setting for the problem of regulation is easily overlooked. Yet at every point in the process of regulation a whole series of conditioning factors determines the direction which regulation takes and the limits within which it must contain itself. Technology, economic organization, ideology, law, and other institutional factors establish the context within which the parties in interest as well as the regulatory instruments are compelled to function. These factors may be labeled institutional because they contribute elements of continuity, stability, and even rigidity to the regulatory process. To attempt to measure the exact impact of each one of these factors on the process of regulation is to undertake a difficult, if not impossible task. Without becoming involved in the morass of controversy as to the respective merits of a multiple causation versus a dominant-factor interpretation of history, the view adopted here is that the most

fruitful approach in disentangling the complexities of the regulatory process is the hypothesis of concomitant variables. Such an approach leaves the causal problem unsolved, but it permits such flexibility of emphasis in interpreting the significant factors in a particular regulatory situation as the concretions of that situation seem to demand.

Yet concretions can be completely meaningless in the absence of a framework of synthesis and interpretation. To understand the regulatory problem in a particular sector of the economy, it is necessary to have some perspective on the whole American institutional setting for government control. Different observers will, of course, disagree on what that setting is and on the implications which they draw from their observations. Most of them would, however, agree that one of the salient aspects of that setting is the fact that the United States has developed a technological society in which the key decisions regulating production and distribution have been made, and to a considerable degree are still being made, by business men operating under the compulsions of the pecuniary discipline. While that society was in its period of dynamic expansion, economic organization, legal institutions, and prevailing ideologies were largely shaped by the needs of business men. In this sense, the society was harmonious. The harmonies were dictated by the objectives of business enterprise, but the realization of these objectives involved the development of the community and hence commanded widespread public support. While the underlying conditions continued favorable to expansion and development, the theory of solidarity of interests remained tenable. It began to be effectively challenged when other groups in the community became convinced that the protection of their interests could not safely be entrusted to the uninhibited strategy of business enterprise. A harmonious society thus became less harmonious. The ascendancy of the business man was disputed. Other parties in interest in industry and agriculture became articulate and organized, and sought to reshape economic organization, legal institutions, and prevailing ideologies to serve their own needs. In that effort they turned increasingly toward the use of governmental instrumentalities to secure the needed readjustments. It was possible to make the effort, first, because the dissident groups commanded numerical strength even when they did not enjoy economic power, and, second, because the existing framework of democratic political institutions provided such groups with avenues of ap-

proach to political power and the opportunity to translate political power into economic power.

REGULATION IN TERMS OF PARTIES IN INTEREST

The expansion of the regulatory authority of government in the economic sphere may be viewed as an exercise in political dynamics. The complex arrangements which go to make up a particular enterprise or industry consist of relationships among various parties in interest — the investors who contribute capital, the control groups which determine policy, the management which provides entrepreneurial and technical direction, the labor which supplies its skill and energy, the consumers who buy the output of the industry, and the other industries which sell raw materials and equipment to that industry. The web of their interrelationships is industry as a going concern. To the extent that all of them are vitally dependent upon the welfare of the industry with which they are identified, a certain mutuality of interests receives recognition, particularly when the problem is one of industry survival. But the problem of allocating the income stream of the industry among the various parties in interest does not lend itself to easy solution in terms of a formula of mutuality of interests. Divergent expectations unleash conflicts, which in the absence of government intervention can only be adjusted in terms of the relative bargaining power which the parties in interest are capable of mobilizing in the economic realm. The resulting relationship is a power relationship in which financial "control groups" have usually occupied the strategic positions. Labor unions represent an effort to redress the balance in one direction; consumers' co-operatives in still another. Such efforts to establish equality of bargaining power may be confined to economic organization and need not necessarily result in the establishment of a scheme of public control to supervise the affairs of industry. But the grievances of economically weak parties in interest frequently do not lend themselves to satisfactory adjustment on the economic plane. Feeling that their interests are inadequately protected under the existing scheme of private controls, they begin to demand public controls and seek to use political power to make their demands effective. The invocation of political power constitutes a form of bargaining, an effort to secure a more satisfactory adjustment of relationships within the industry by utilizing political power to curb the private economic power of the "control groups" which

had previously determined these relationships. To the extent that industrial policy is merged with public policy, the parties in interest in industry are forced to become and remain active in the political arena in order to assert and advance their claims.

The character of this activity, the strength and weakness of the parties in interest who are concerned with the determination of policy, the combinations and alliances which they form, their influence in the general institutional setting — these become very important factors in determining the nature of regulatory policy and the extent to which it accomplishes or fails to accomplish the objectives of its sponsors. Each industry, to be sure, presents its own special characteristics and peculiar problems; the power of the parties in interest varies with the particular industry, and the patterns of control reflect these variations.

Yet an analysis of the experience of a regulated industry in terms of the parties-in-interest conception does much to illuminate the process of regulation. It lays bare the power relationships which prevail in a given sector of economic life; it offers a clue to the dynamics of their interplay; in the political arena it reveals in a general fashion at least the possibilities and limits of adjustment between them. It may also make clear that there are groups with vital interests in regulation which are ignored; that there are other parties in interest who perhaps exercise more power in shaping policy than ought properly to be exercised by them.

Each party in interest in a regulated industry seeks to guide its conduct in terms of two controlling considerations. Its general interest in the organic strength and prosperity of the industry with which it is identified leads it to support such public measures as appear designed to protect and promote the position of that industry in the total economy. At the same time, its special interest in improving its own relative position within the industry drives it to embody its particular objectives and ambitions into public policy. Around the realization of these aims it develops its own strategy of attack and defense. The materials of both compromise and conflict are contained in this dual relationship.

The first objective — which is industry-wide in scope — is subject to only limited realization through the manipulation of public policy. In an economy characterized by sweeping technological changes and cyclical fluctuations an industry may go through expanding and declining phases independent of any course of action which the parties in interest who make up that industry pursue.

The industry is exposed to the disturbance of outside forces beyond its power to control, and neither governmental nor private action can altogether prevent the maladjustments which flow from these disturbances.

While an industry is in its phase of dynamic expansion, the resistance to regulation on the part of its "control groups" is likely to be most intense and most effective. "Control groups" naturally see no need for regulation in the premises, and management and investors are likely to identify their policy with that of the "control groups" as long as the industry is prosperous and their own special interests are safeguarded without government intervention.

The special interests of labor ordinarily assert themselves first in the non-governmental field of collective bargaining; as long as the economic setting is favorable to concessions on that plane, the pressure for special protection in the form of legislation is diverted. The dissatisfactions which produced the beginnings of regulation in expanding industries in the United States have been chiefly consumer in origin. They have been effective when the political milieu has been favorable; consumers who have found themselves in a seriously disadvantageous position, as in the case of farmers and small business men in the railroad field, have provided most of the initial driving impetus behind the regulatory movement.

The pressure for regulation in contracting or depressed industries takes a different form. An industry in decline poses the unpalatable prospect of sacrifices for all parties in interest — "control groups," management, investors, and labor, as well as consumers. Each party in interest hopes to avoid these sacrifices so far as circumstances permit. When possible, each seeks to shift the burden of readjustments to other interests. Thus the stage is set for maneuver on both the economic and the political plane. "Control groups," management, and investors usually exert pressure to reduce labor costs. If labor is effectively organized, these efforts meet with resistance. Given a favorable political milieu, labor turns to politics in the effort to secure special protection in the regulatory scheme of the industry. Investors, too, seek to shape regulatory policy to salvage their financial stake in the industry; they may also demand protection from exploitation by the "control groups." In so far as "control groups," management, investors, and labor are bound together by their common stake in the industry, there is considerable incentive to collaborate. Alli-

ances may be formed to throw the burden of maintaining the industry on the consumers of its products; "control groups," investors, and labor may join in appealing to government for aid and assistance in the shape of direct pleas for loans, subsidies, and other aids designed to maintain the industry as an active enterprise, or in the form of legislation designed to repel the attack of the invader — as in the case of the railroads' demand for more effective regulation of competitive modes of transportation. When an industry enters its declining phase, the authority and prestige of the "control groups" break down; the whole tendency is to turn to government to supply the leadership and direction formerly supplied by the "control groups." A new conception of regulation emerges. The parties in interest in acute distress call upon government to foster and promote their welfare and the industry upon which they are dependent. Regulation which was negative and restrictive in the sense that it was primarily designed to protect consumers and other parties in interest against abuse of power by the "control groups" now takes on more positive and comprehensive forms. Its task becomes nothing less than salvage and rehabilitation; the responsibility thrust upon it is that of guiding and controlling the destiny of an industry in all its aspects.

But the alignment and effectiveness of parties in interest in the regulatory process are not only influenced by secular and cyclical trends. The capacity which parties in interest show for cohesive organization, the extent to which their needs and aspirations find a sympathetic sounding board in the dominant political leadership of the day are also factors of marked importance in determining the role which they play. The development of regulation in a particular industry cannot be isolated from the broader movement of social and political forces through which the demand for such regulation must find expression if it is to leave its impress upon public policy. The influence which the parties in interest in a particular industry exert at any given time is largely measured by their ability to find effective political champions or allies capable of fusing their demands into a general program of wider appeal.

The great periods in the expansion of regulation of industry in the United States have been periods in which parties in interest demanding regulation in particular industries have found political channels through which to make their demands effective. They have coincided with reform and progressive movements, with

agrarian uprisings, with mounting expressions of dissatisfaction on the part of small business men and middle-class groups, with the rise of labor as an organized and articulate force. The Granger movement of the seventies, the first great thrust of national regulation marked by the passage of the Interstate Commerce Act in 1887 and the Sherman Antitrust Act in 1890, the strengthening of national controls under Theodore Roosevelt symbolized by the enactment of the Hepburn Act in 1906 and the simultaneous establishment of utility commissions in a number of states, the further growth of regulation under Woodrow Wilson, the tremendous upsurge under the New Deal — each of these has represented a blending of the demands of particular parties in interest in particular industries into a broader political pattern in which the demands of these special interests have been merged. The dynamic factors in this political pattern have shown some variations over the years. The impetus behind the Granger movement was predominantly agrarian. The legislation of 1887 and 1890 represented a response to the pressure of small business men as well as farmers expressing itself through both political parties. The reforms of the first Rooseveltian era registered the aspirations of the progressive middle class. The Wilsonian New Freedom canalized many of these same interests; while its primary appeal was to the smaller business men and farmers, it also gave substantial recognition to labor. The New Deal in its main trends has continued this line of development. Labor and farmer interests have bulked large in the picture; financial "control groups" have been subject to sharp attack; appeals have been directed to the body of small investors in the hope of detaching them from their former loyalty to the "control groups." The flow of energy which accounts for the multiplication of regulatory agencies has come in periodic upsurges, but there is an essential continuity in the character of the groups who have pressed for the extension of regulation.

Just as the great periods of expansion of regulation have vocalized the aspirations of farmer, labor, and middle-class progressive groups, the great periods of frustration of regulation have come at times when big business and finance have been firmly in the saddle, and their political spokesmen have dominated the regulatory machinery. The McKinley era during the late nineties and the opening of the twentieth century registered the low-water mark of the Interstate Commerce Commission and the virtual suspen-

sion of the Sherman Antitrust Act. During the 1920's, when a resurgent business leadership maintained a powerful grip on the political machinery, existing regulatory agencies suffered an eclipse, and efforts to provide for more effective regulation were successfully thwarted. State utility commissions were notably ineffective during this period; the Federal Trade Commission was transformed into an agency to foster business self-government; the Federal Power Commission was virtually impotent; even the Interstate Commerce Commission, for all its traditions of independence, was influenced by the dominant political currents of the day.

The ebb and flow of social energy through which the dynamic parties in interest find expression thus serves to control the scope and character of regulatory activity. The intermediary processes by which particular parties in interest transmit their influence to the political realm vary with the tools and instruments at their disposal. In the case of the "control groups," power and influence derive basically from the financial resources under their control, and the strategic positions which they occupy in the organization of industry. The "control groups" in a particular industry are themselves part of a larger social entity; they belong to the upper strata of business and finance; they are bound together by a highly centralized system of banking and financial interrelationships. Community of interest breeds homogeneity of outlook and substantial agreement on desirable policies to be pursued. In so far as regulation threatens to impose limits on the power of the "control groups," they naturally oppose it; if hostile regulation is enacted, they seek "to regulate the regulators." In achieving these purposes, their basic problem is to transmute economic power into political power. That problem, in the past at least, has not defied solution. A flow of campaign contributions into both major political parties, direct pressure on state and national legislatures through hired "lobbyists" or paid legislative agents, extensive public relations campaigns designed to manufacture favorable opinion at the source of political action, ownership of newspapers and other purveyors of opinion, a barrage of lawsuits designed to hamper or delay the application of unwanted regulatory activity — these and other widely used instruments and techniques bear witness to the pervasive influence of the cash nexus when it is geared to the need of political action. In this fashion the "control groups" are able to generate power and carry on a politics of

aggrandizement calculated to absorb other parties in interest into their own sphere of influence.

Management, in so far as it can be separated from control, may treasure aspirations of its own, but it is unlikely to make them politically articulate. Its intimate dependence upon the "control groups" leads it, with rare exceptions, to identify its own interests with the interests of the "control groups," and to support the latter's program. The same can usually be said of the body of small investors, at least in periods when the industry under consideration is prosperous and the flow of income to investors is uninterrupted. Under such circumstances, the bulk of investors take their lead from the policies proclaimed by the "control groups"; they are the privates in an army of which the "control groups" are the general staff. It is only when the industry falls upon evil days or when financial manipulation by the "control groups" at the expense of investors is revealed that the allegiance of the investors begins to waver. Organization for independent political action, however, presents its difficulties. The institutional investors — insurance companies, banks, universities, and foundations — possess a degree of cohesion which lends itself to effective organization; the bulk of small investors are dispersed, scattered, and organizable only with great difficulty. Consequently, when the time of trouble comes, they are likely to look for leadership rather than to take leadership themselves. They may follow the lead of the institutional investors. Political spokesmen prepared to hold out hopes of salvaging their investments or offering regulation calculated to protect them from exploitation by the "control groups" may engage their loyalties; sheer inertia and traditional attachments may operate to continue the loyalty of investors to the "control groups," particularly if the latter are successful in playing upon the investors' fears of governmental action.

Such influence as labor exerts in the regulatory process is primarily attributable to the disciplined voting strength which it can command. Divisions within the ranks of labor between craft and industrial unionism, between skilled and unskilled and organized and unorganized workers, cleavages that develop between workers in competitive industries, weaknesses of organization and leadership, have all served to make the political influence of labor less significant than its potential united voting power would seem to warrant. In regulated industries in which labor is effectively organ-

ized, as in the railroad field, the role which labor plays in the determination of public policy is commensurately large, but its influence varies with the general strength of the labor movement and the ability of labor leadership to operate effectively through one or both of the major political parties. The nonpartisan policy of supporting friends and voting against enemies of labor regardless of party label has been the traditional *modus vivendi* on which the politics of labor in the United States has been based. By pursuing this cautious policy, labor has extracted concessions at various times from both major parties. Historically, however, labor has flourished most impressively when it has associated its destinies with friendly leadership of the Woodrow Wilson, Franklin Roosevelt type; failing the emergence of an independent labor party, in all likelihood it will probably continue to make its influence felt through such receptive elements in existing political parties as appear willing to work with it.

The role of the consumer in the regulatory process is largely an unexplored mystery. The self-organization of consumers is still a rarity in the United States. There are exceptions — the larger shippers in the railroad field, for example, are very effectively organized — but in regulated industries where the stake of the individual consumer is relatively slight the incentive to active collaboration is absent. Telephone subscribers and domestic users of electricity, for instance, are unlikely in normal circumstances to take vigorous steps to form associations to represent their interests. They may be conscious of grievances; the feeling that they are being unfairly dealt with may express itself in periodic outbursts of indignation which political spokesmen may succeed in vocalizing and even harnessing for purposes of legislation; but when the indignation subsides, the dynamic pressure for effective political representation of consumer interests subsides also. No effective organizational residue remains to provide a sustained and continuous criticism of regulatory policy in terms of consumer interests.

The problem of securing effective representation of consumer interests has evoked a variety of responses, some clearly makeshift, others more promising in the direction of their development. The occasional emergence of individual champions of consumer interests and *ad hoc* associations created for some specific emergency is at best a none too satisfactory substitute for permanent awareness and organization. Consumers' coöperatives offer an or-

ganizational framework within which consumer consciousness may be aroused and through which consumer interests can be expressed in a sustained fashion, but as yet they are inadequately developed in the United States. The periodic revolts of consumers which express themselves through the medium of the political parties leave behind them a deposit of controls and regulatory agencies, but the regulatory agencies themselves find it difficult to serve as vigorous protagonists of consumer interests in the absence of an active and continuous manifestation of consumer support. Regulatory agencies may, within limits, generate consumer support for their activities, but such activity is hedged about by the resources of the agency and the pressure of other interests. Because of this pressure, some regulatory agencies have been forced to abjure the role of positive defenders of consumer interests and have taken notice only of such consumer complaints as are brought to their attention by organized consumer groups. In some jurisdictions the office of Consumers' Counsel has been established to facilitate the representation of consumer interests and to provide a specific instrument designed to bring such interests to a focus. The effectiveness of this device depends on the place of the Consumers' Counsel in the regulatory scheme. The office may be simply a sop thrown in the direction of consumers, with limited power, inadequate financial support, and little possibility that it can be made into an effective consumers' agency. With adequate resources and vigorous leadership, the office may well serve as a rallying point at which consumer interests can become articulate and from which consumer support can be organized and mobilized for action. The obstacles to successful consumer organization are formidable; the provision of nuclear centers around which consumer organizations can grow establishes a basis at least for effective consumer representation.

THE PATTERN OF OPERATIVE CONTROLS

The influence which particular parties in interest exert in the regulatory process is not only a product of their native capacity for organization and the power which they are able to generate in the political sphere. It is also dependent on the existing pattern of regulatory agencies and on the degree to which these instruments of regulation respond to or resist the pressures to which they are exposed. The instruments of regulation — in a broad sense — operate on every level of governmental action through

which the play of particular interests is sifted and public policy is defined. In this sense, competitive party politics, legislative activity, the exercise of administrative discretion, and judicial determination all contribute to make up the pattern of operative controls. Each of these instrumentalities has its own appropriate role to play in the process of regulation, and each presents its own possibilities of adjustment and manipulation.

Within this broad framework, however, the vast expansion of regulatory activity has precipitated significant shifts in the locus of actual control and in the relationships among the various levels in the regulatory hierarchy; it has stimulated a search for new forms of organization, new techniques, and new sanctions to meet the challenge of the new responsibilities assumed by modern governments. The direction of this shift in the center of gravity of governance was aptly summarized by Dean Pound in an address to the American Bar Association in 1919:

> In the beginning of our political history, the legislative department was the leader. . . . Next for a time, and notably from the enactment of the 14th amendment to the first decade of the present century, the courts achieved a definite leadership. . . . For nearly half a century the judicial hegemony was scarcely disputed. . . . Today the executive thinks of itself and is thought of as peculiarly representing the whole people. . . . The hegemony of the executive is at hand. As the 18th century and the forepart of the 19th century relied upon the legislative, and the last half of the 19th century relied upon the courts, the 20th century is no less clearly relying upon administration.[2]

The history of the growth of railroad regulation in the United States offers a kaleidoscopic demonstration of the character of these changes. To begin with, railroad regulation was primarily legislative in character.[3] Promoters wishing to construct railroads were required to obtain a charter from the state; such charters were at first granted by special statutes; later they were obtainable under general laws. "By 1869," Professor Leonard White points out, in Massachusetts alone, "over a thousand statutes, general and special, had been passed to define the legal position of the railroads."[4] Direct legislative regulation, however, proved cum-

[2] See Association of American Law Schools, *Selected Essays on Constitutional Law* (Chicago, 1938), IV, 76–77.

[3] See I. L. Sharfman, *The Interstate Commerce Commission* (New York, 1931), vol. I.

[4] "The Origin of Utility Commissions in Massachusetts," *Journal of Political Economy* (1924), XXIX, 185.

bersome and ineffective. The mass of legislation was a labyrinthine maze in which only the railroad lawyers could find their way. No effective supervisory machinery was provided; *ad hoc* legislative investigating committees proved inadequate. In theory, the common law and the courts provided remedies for aggrieved shippers. In practice, as Dean Landis has indicated, such remedies "were more apparent than real because of the costly and uncertain character of the legal actions that had to be pursued. The need for nondiscriminatory and reasonable rates, uniformly applicable, could not be achieved through the intermittent intervention of the judicial process." [5]

The result was a search for new expedients to secure stricter supervision of the railroads. The device hit upon was the administrative board or commission. Starting with occasional commissions appointed to inspect the roads for safety, and to investigate whether the railroads were obeying their charters and laws, the functions of these commissions broadened out until they came to embrace rate-making. As evidence accumulated that the railroad industry was national in scope and could not be effectively regulated through state instrumentalities, Congress borrowed the device of the administrative commission and in 1887 established the Interstate Commerce Commission. That agency began its life with limited powers and narrowly defined objectives. Its efforts to make effective use of the meager powers granted to it met with suspicion and frustration in the courts. Without declaring the Interstate Commerce Act itself unconstitutional, the Supreme Court during the nineties interpreted many of its leading provisions in such a fashion as to paralyze the activities of the Commission. Statutory construction became an instrument of judicial nullification of administrative action.

But the tide which was ushering in the growth of administrative discretion could not be so easily stemmed. Beginning significantly with the Hepburn Act of 1906, a steady stream of Congressional legislation invigorated the powers and jurisdiction of the Interstate Commerce Commission. Its authority was expanded until it came to include not only rate-fixing but virtually the whole range of railroad operations — construction and abandonments, through routes, physical connections and extensions, safety regulations, issuance of securities, consolidations, interlocking directorates and holding companies, accounting and reports, and so forth. In most

[5] James M. Landis, *The Administrative Process* (New Haven, 1938), p. 9.

of these fields the Interstate Commerce Commission was vested with vast discretionary authority, its exercise of such authority limited only by vague statutory standards requiring its action to be "just," "reasonable," or "in the public interest." The freedom to choose between alternatives which such broad grants of power involved was still subject to judicial check; but with an increasing realization that the complex problems of railroad regulation could be more effectively dealt with through the administrative rather than the judicial process, the courts began to manifest a deference toward the Interstate Commerce Commission as an agency "appointed by law and informed by experience" which was notably nonexistent during the nineties. With the expansion in its area of autonomous operations, the Interstate Commerce Commission, to an increasing degree, carried the actual burden of railroad governance; its powers overran and encompassed all the traditional categories of executive, legislative, and judicial; its authority was extended into the adjacent field of motor-carrier regulation.

This evolution from legislative to judicial to administrative control which has been described in the railroad field can be noted, to a greater or lesser extent, in other fields of industry regulation. The general tendency has been to rely more and more upon administrative instruments to perform the task of supervising industry. No consistent principle has marked the choice of the type of agency to which new regulatory functions have been assigned. Congress and the state legislatures have been influenced by a variety of considerations, such as the established precedents, the resemblance of a new function to an already existing function, the novelty of the function, the rivalries of existing administrative agencies, the pressure of the interests to be regulated, the political relationships between the executive and legislative departments, and the like. Sometimes regulatory functions have been entrusted to existing executive departments. More frequently independent commissions have been created as new fields of industrial regulation have opened up.[6]

[6] Professor Robert E. Cushman, in his "The Problem of the Industrial Regulatory Commissions" (President's Committee on Administrative Management, *Report with Special Studies*, Washington, 1937, pp. 216–217), summarizes the more important reasons for the establishment of independent regulatory commissions as follows: (1) more impartial performance of quasi-judicial duties by an administrative agency; (2) fear of political pressure in the executive departments; (3) greater ease of securing services of experts in an independent agency than in executive departments; (4) necessity in some cases of providing for regional representation; (5) novelty of the regulatory task, making it desirable to create a new agency; (6)

The great functional imperative behind the development of the commission movement was the need for specialization in regulatory activity. Commissions emerged and became instruments of governance for industry precisely because legislatures and courts proved unable to meet this need, and because the executive departments did not promise the environment in which specialized knowledge would flourish. Commissions commended themselves because they offered the possibility of achieving expertness in the treatment of special problems, relative freedom from the exigencies of party politics in their consideration, and expeditiousness in their disposition. The fact that the commission addressed itself to a defined and limited subject matter, the continuity of experience made possible by its scheme of organization, its resources for investigation and consultation, all tended to facilitate the acquisition of special competence within its field of operations. The commissions were organized to function as governments in miniature. They had power to make investigation; frequently they issued rules and regulations; they brought complaints; subject to judicial review, they adjudicated controversies within their area of activity. The resulting admixture of functions appeared on its face to be a gross violation of the strict canons of separation of powers. Yet it had the positive advantage of being admirably adapted to the realization of the values which the commissions were created to foster. It promoted celerity and dispatch in the disposition of business.

SUGGESTED REORGANIZATION OF THE REGULATORY COMMISSIONS

The multiplication of independent regulatory commissions has resulted in a dispersion of regulatory authority. "Viewed as a whole," Mr. A. H. Feller has observed, "they [the regulatory commissions] do not present a particularly neat picture of administrative symmetry. But if they do not satisfy the eye of the efficiency expert, they do represent an organic growth. . . ."[7] Starting with the Interstate Commerce Commission in 1887 and extending through the New Deal, Congress has frequently turned to the independent commission as a useful instrumentality to open up

experimental character of the task, leading to establishment of a commission to explore the field; (7) popular belief that rule-making functions ought to be performed by a group rather than a single officer; (8) prestige of the I.C.C. as a model for subsequent action.

[7] "Administrative Justice," *Survey Graphic*, October 1938, p. 528.

new areas of business regulation. In providing for bipartisan representation, staggered terms, and long tenure, Congress has made an effort to secure continuity in policy, stability and impartiality in administration, and relative freedom from political domination in the day-to-day administration of the commission's affairs. The result, in the opinion of the President's Committee on Administrative Management, has been the growth of "a headless 'fourth branch' of the Government, responsible to no one, and impossible of coordination with the general policies and work of the Government as determined by the people through their duly elected representatives." [8] To many this indictment will appear intemperate and extravagant. The "independence" of the commissions is, after all, circumscribed by numerous limitations. The president has the power of appointment subject to senatorial approval, and he may remove commissioners for inefficiency, neglect of duty, or malfeasance in office. The commissions operate under statutory authority. Congress may always add to or subtract from the powers of the commission. It controls the funds upon which the commission depends to perform its work. Congress may, if it sees fit, abolish its own creation. The courts, too, may contract or expand the discretionary authority which Congress has vested in the commission. Lines of responsibility reach out in all three directions, toward the president, toward Congress, and toward the courts. It remains true, however, that when a vigorous change of policy is initiated by the electorate, Congress, and the chief executive, and the execution of such policy is partially, or wholly, dependent upon an independent commission dominated by personnel out of sympathy with that policy, inactivity and hostility within the commission may serve to frustrate or delay the realization of new social values. To guard against such a contingency, as well as to meet the objection against the prosecutor-judge combination found in the commissions, the President's Committee on Administrative Management proposed to bring the policy-forming and administrative activities of the independent commissions under direct executive control, while reserving independence for their adjudicative functions. In the storm of controversy which this proposal aroused, the attitude of many was determined by their sympathy or lack of sympathy with the program of the administration in power. To some who identified their values with the values of the national administration, it appeared self-evident that the lines of

[8] President's Committee on Administrative Management, *op. cit.*, p. 32.

policy followed by the executive departments ought likewise to be followed by the independent commissions. To those who opposed the administration's program, it appeared equally self-evident that the retention of the independence of the commissions offered an additional possibility of generating opposition to that program.

The issues involved in the proposal, however, transcend the level of temporary political advantage. Granted that it is undesirable to permit a commission to pursue general policies counter to the will of the voters and Congress, is the absorption of the administrative and rule-making functions of the commissions into the executive departments the wisest way of meeting the problem? Are there other values inherent in the present scheme of organization of the independent commissions which would be lost by the proposed change?

Blue-print symmetry, it is worth remembering, does not always bring about the harmony of policy which is claimed as one of its primary advantages. If the proposal of the President's Committee were accepted, presidential control would presumably be strengthened. But presidential policies and Congressional policies are not necessarily nor continuously synonymous, and in the event of a difference of opinion between the president and the independent commissions, it is at least conceivable that the commissions may be closer to the expressed policy of Congress than the chief executive. Is there any compelling magic in presidential leadership which automatically entitles it to preference? Admittedly, there is a need for more effective coöperation and coördination between the president and the commissions, and among the commissions themselves. But there are, after all, other channels for achieving such coöperation short of executive absorption of the administrative activities of the commissions.

Would the functions performed by the present commissions be more effectively performed after the proposed split-up? No satisfactory general answer can be given. Existing independent commissions show wide variations in the administrative efficiency with which they perform their regulatory functions. Similar disparities of performance characterize the executive departments. The incorporation of the administrative activities of some commissions into some executive departments might conceivably result in heightened efficiency; other transfers can be readily visualized where the result would almost certainly be a lowering of existing standards of efficiency and a marked increase in political inter-

ference in day-to-day administration. The proposed split-up of the independent commissions into administrative and judicial sections is not without its real practical difficulties; the resulting cleavage between administrative and judicial sections might conceivably breed greater conflict, irresponsibility, and inefficiency than the present admixture of functions.

The issues which the proposal of the President's Committee raises cannot be resolved in terms of general abstractions. One suspects, however, that, if they are resolved at all, it will not be in terms of an undiscriminating application of an over-all formula, but out of the specific experience of particular regulatory commissions and in terms of specific proposals for improvement arising out of the difficulties disclosed by that experience.

The problem of transforming the independent commissions into more effective regulatory instruments goes far deeper than the problem of their relationship to the president. It involves questions of personnel and adequate financial support; it extends into the area of relationships with Congress and the courts, as well as with the chief executive. It involves the even more fundamental question of whether the disposition of social and economic forces is such as to enable the regulatory agencies to perform their task of adjustment in a creative fashion. In so far as the question is one of competent personnel, it raises the whole problem of patronage in the public service and the difficulty of its elimination. In so far as the problem is one of adequate financial support, administrative reorganization by itself is not calculated to be very helpful. The budget of the commissions must run the gamut of hearings before the Bureau of the Budget, presidential recommendations, hearings before the Congressional appropriations committees, and Congressional determinations. This position of dependence necessarily forces the commissions to ingratiate themselves with the chief executive and Congress; they must cultivate friends to plead their cause if their work is to go on. The task of assessing the activities of the commissions, of deciding what parts of their work need to be curtailed and what expanded, is, in the final analysis, the responsibility of Congress. It offers opportunities for frustration as well as creative direction, since the Congressional control of the purse strings ultimately determines both what the commission can do and what it cannot do. This important aspect of the external relations of the commissions deserves more attention than it has yet received; investigation may disclose considerable possibilities

of improving the intermediate procedures by which the needs of the commissions are made known to Congress and through which those needs are evaluated.

The character of the legislative standards under which the commissions operate also may determine the success or failure of their operations. The difficulties encountered in this sphere run in different directions. Sometimes Congress burdens the commissions with over-explicit and mechanical directions in situations where more discretion and flexibility of choice would enable the commissions to perform their task more efficiently. In other cases Congress provides standards which are either vague or contradictory. Faced with social cross-purposes, legislators may embody their own doubts and hesitations into law, leaving it to the commission to resolve the confusion. The plight of the administrative agency which inherits such contradictions is unenviable; not only does the full force of conflicting interests descend upon it, but the courts reserve the final power to divine and govern. The commissions are thus intimately dependent upon legislative coöperation to create the conditions under which they can function with maximum effectiveness; unless the legislature is able to define its objectives with clarity, while at the same time leaving the commission considerable flexibility in carrying them out, the full potentialities of the commission as an administrative device cannot be realized.

Another source of difficulty is traceable to excessive interference by the courts. The independent commissions have had to win their way to recognition and relative freedom of action in the face of a deeply rooted tradition of subordination of administration to the judiciary. In defining the course of administrative policy courts tended to assume that the authority with which they were vested made them, in Coke's phrase, "superintendents of the realm." The disposition to identify the doctrine of the Supremacy of Law with the professional traditions and interests of the legal profession generated suspicion and hostility toward the processes of administration, particularly when the latter could not be fitted into the categories evolved as a result of the application of the techniques of common law legal reasoning. The struggle thus came to be waged with legal concepts and phrases, but underlying the verbal dialectics was the more far-reaching issue of whether effective governmental regulation was to be frustrated or implemented.

Judicial supremacy in the long run proved powerless to arrest the trend toward the development of regulatory agencies with

specialized equipment; it has nevertheless frequently imposed serious handicaps upon the use of administrative legislation and adjudication as techniques for the performance of the regulatory task. The readiness of courts to go behind administrative findings of fact and weigh the evidence themselves has endangered the very virtue of specialized knowledge which constitutes one of the chief justifications for the establishment of commissions. Under legislative pressure, the tendency has been for courts to retreat and accept the rule that administrative findings of fact, if supported by evidence, are conclusive. Certain areas remain, however — particularly in the domain of so-called "jurisdictional" or "constitutional" facts — where the courts' power to pass on evidence is still reserved,[9] The consequences in the field of public utility rate-making — to cite only one glaring example — have not added to the luster of the courts.[10] The tendency recently evinced by the Supreme Court to "set up a detailed code of procedure for administrative proceedings" may conceivably be more efficacious in impeding effective enforcement of the law than in securing the "fair hearing" which the Court appears anxious to foster.[11] The same tendency has recently penetrated the area of administrative legislation. The courts, of course, reserve the power to decide whether a particular administrative regulation is *intra* or *ultra vires*; some recent decisions intimate a further tendency to set up detailed procedural prerequisites to the promulgation of administrative regulations.[12]

[9] See *Ohio Valley Water Co. v. Ben Avon Borough*, 253 U. S. 287 (1920); *Crowell v. Benson*, 285 U. S. 22 (1932); *St. Joseph Stock Yards Co. v. U. S.*, 298 U. S. 38 (1936); *Baltimore and Ohio Railroad Co. v. U. S.*, 298 U. S. 349 (1936). All these cases were decided by a divided court. Recent and impending changes in the personnel of the Court are likely to bring new recruits to the minority position which would involve a drastic limitation of judicial review in this field.

[10] See Mr. Justice Brandeis' concurring opinion in the St. Joseph Stock Yards Case, *loc. cit.*, particularly pp. 88ff., in which he cites the Court's responsibility for the delays and costs of the Chicago and New York telephone rates cases.

[11] See *Morgan v. U. S.*, 298 U. S. 468 (1936); also *Morgan v. U. S.*, 304 U. S. 1 (1938).

[12] See *Panama Refining Co. v. Ryan*, 293 U. S. 398 (1935), and *U. S. v. Baltimore and Ohio Railroad Co.*, 293 U. S. 454 (1935), for recent expressions of the view that administrative regulations must be buttressed by findings of fact in order to have validity. But see *Pacific States Box and Basket Co. v. White*, 296 U. S. 176 (1935), where in answer to the contention that an order was void because the administrative body made no special findings of fact the Court pointed out (p. 186) that "the statute did not require special findings; doubtless because the regulation authorized was general legislation, not an administrative order in the nature of a judgment directed against an individual concern." See A. H. Feller, "Prospectus for the

The danger of arbitrary conduct in the administrative applications of legal standards is, of course, a real one, and the expertness of administration is not always above suspicion. But it must be remembered that the courts do not provide the only safeguard against the abuse of power, and that the judicial safeguard may itself be carried so far as to interfere seriously with the performance of the regulatory task. As Professor Frankfurter has well said,

> After all, the Constitution is a *Constitution*, and not merely a detailed code of prophetic restrictions against the ineptitudes and inadequacies of legislators and administrators. Ultimate protection is to be found in the people themselves, their zeal for liberty, their respect for one another and for the common good — a truth so obviously accepted that its demands in practice are usually overlooked. But safeguards must also be institutionalized through machinery and processes. These safeguards largely depend on a highly professionalized civil service, an adequate technique of administrative application of legal standards, a flexible, appropriate and economical procedure . . . , easy access to public scrutiny, and a constant play of criticism by an informed and spirited bar. . . .[13]

There is, of course, much that can be done to improve the operations of the independent commissions and regulatory agencies generally, but it is at least doubtful whether blanket mandates from the courts, calculated to impose fixed and unyielding procedures on such agencies, are the appropriate remedies for their deficiencies. In some instances hearings and findings of fact as a prerequisite to the issuance of regulations may have real utility; in others, their utility may well be doubtful.[14] In some instances, the encouragement of indirectly affected interests to participate in administrative proceedings will be beneficial; in others, sharp limits on the right to participate will be necessary in order to prevent the proceeding from being overwhelmed by intervenors. Existing commissions show wide variations in the carefulness with which their findings are drawn in adjudicative proceedings. Some are

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Further Study of Federal Administrative Law," *Yale Law Journal*, XLVII, 647, 668; also Landis, *op. cit.*, p. 148.

[13] Felix Frankfurter, *Introduction* to Patterson, *Insurance Commissions in the United States* (Cambridge, 1937), pp. xi, xviii, reprinted in Association of American Law Schools, *op. cit.*, IV, p. 4.

[14] See Feller, *Yale Law Journal*, XLVII, and James Hart, "The Exercise of Rule-Making Power," in President's Committee on Administrative Management, *op. cit.*, pp. 313ff.

admirably complete; others are so perfunctory as to be virtually useless. Improvements in meeting the requirement for carefully drawn findings would probably not be without effect in persuading the courts to narrow the scope of judicial review of administrative action. The same can be said of the general spirit of fairness of the administrative body. To the extent that regulatory agencies generally develop organizational forms and procedural rules which incorporate the substantial requirements of fair play, it is probable that the courts may be led to withdraw further from the field of rigid control of the administrative application of legal standards.

The effective operation of the independent regulatory commissions thus depends upon a variety of conditions. It involves personnel reforms, improved relations with Congress and the courts, as well as with the president; it requires changes in internal organization and procedure as difficulties are disclosed. In a more profound sense, however, it also involves the existence of a social and economic environment in which regulators can function without meeting frustration. Improvements in the instruments alone and readjustments of their relationships may be powerless to achieve the purposes which they are intended to serve in the absence of a milieu congenial to the realization of these purposes.

THE REGULATORY AGENCY AS A CREATIVE FACTOR IN PUBLIC POLICY

The growth of administrative discretion has emphasized the creative role which regulatory agencies can play in defining the scope and direction of public policy. In theory at least, and frequently in practice, they are capable of recognizing some interests as more "public" or more "general" than other interests and of adapting, fusing, and directing group pressures toward such a recognition. In the process of exercising their discretionary power, regulatory agencies are often in a position to create some pressures and to extinguish others, to stir dormant parties in interest into activity and to anesthetize others, to mobilize groups to come to their support and to penalize opposition. Investigation may deflate pretensions and reveal divisions and minorities within groups which are spoken for as units. The impact of the articulate may be softened by the gentle ministrations of discreet inquiry. The manipulative power of regulatory agencies may be utilized to maintain an existing equilibrium of interests; it can be used to tilt the scale and create a new equilibrium. Within limits, the strate-

gic discretion vested in regulatory agencies can become a real creative force in determining the substance of public policy.

Yet it is important to recognize that there may be an order of subjects of progressive difficulty which will determine the degree to which regulators may develop manipulative power. Certainly the experience of various regulatory commissions suggests wide differences in the degree of manipulative power achieved. Some, like the Interstate Commerce Commission, have been relatively successful. Others, like the Federal Trade Commission, have encountered a series of disappointing reverses. The Interstate Commerce Commission has been comparatively free from political interference. The Federal Trade Commission, on the other hand, has undergone sharp reversals of policy as a result of changes in the political climate. The Interstate Commerce Commission after twenty years of frustration by the courts achieved a growing sphere of autonomous action. The Federal Trade Commission, until recently, continued to be hamstrung by the courts.[15] The Interstate Commerce Commission has been aided by a steady stream of Congressional legislation broadening its power and jurisdiction. The Federal Trade Commission has been much less successful in mobilizing Congressional support. Burdened by an uncertain legislative policy, without the benefit of adequate guiding criteria, and operating in a highly controversial sector of the economy, the Federal Trade Commission has enjoyed indifferent success. Aided by reinforcing legislation from Congress, and operating in a field where regulation wins widespread acceptance, the Interstate Commerce Commission has developed much more manipulative power and achieved a relation to the railroad system of the country, described by the Supreme Court as one of "fostering guardianship and control." [16] In both cases the commissions were established to develop new social values in the public interest. The Interstate Commerce Commission developed them. The Federal Trade Commission met a series of frustrations. The conclusion which suggests itself is that the degree of manipulative power which commissions can achieve in defining public policy is in large part dependent upon the strength and clarity of the communal purpose which initiates and sustains them.

In areas where the common purpose is clearly formulated and

[15] See *F. T. C. v. R. F. Kepple and Bros., Inc.*, 291 U. S. 304 (1934), for signs of a change of attitude.

[16] *Dayton-Goose Creek Ry. v. U. S.*, 263 U. S. 456, 478 (1924).

widely shared, regulatory agencies find their task lightened and the opposition of particularistic interests is relatively easily overcome. At the opposite extreme there are other areas where a new thrust of government inevitably precipitates sharp clefts in the community. Regulatory authorities forced to operate in such an atmosphere of intense social conflict necessarily find their task extraordinarily difficult. "While opposite convictions still keep a battle front against each," Justice Holmes once observed, "the time for law has not yet come. . . ."[17] *Inter arma leges silent.* A fundamental disruption of consensus which divides the community into armed camps necessarily has the effect of transforming the "mediating" authorities into a battalion in one of the armies.

Between the two extremes set forth above, conflicts of purpose and shared aspirations may be intermingled in various degrees. When the purposes which various interest groups proclaim are in partial conflict, there may still be sufficient common ground to permit regulatory authorities to perform their task of adjustment. The skill with which they build on shared purpose will determine the degree of manipulative power which they can acquire. Where common purpose is in process of emerging and consensus begins to be widely shared, the manipulative power of regulatory authorities can be exercised with growing confidence. In emergent areas of community they may count on a swelling reservoir of public support. There are other areas where "the notion destined to prevail" is still far from clear. Crystallization of common purpose has not yet taken place. Regulators are still groping in the dark — confined by circumstance to tentative and hesitant efforts to gauge pressures and movements, risking action if they are bold, standing pat if they are timid. Here are the frontiers of control where an articulate common impulse has not yet emerged from the subsoil of human aspirations, where a new law is an adventure, and administrative agencies experiment at their peril. Daring leadership may arouse hitherto inarticulate desires and carve out a new pattern of public interest. But it may also meet the inertia and hostility which invite repudiation.

The tremendous growth of government regulation in recent years inevitably multiplies the number of strategic points in the economy at which regulatory agencies exert manipulative power. Whether for good or ill, important sectors of the economy have

[17] O. W. Holmes, *Collected Legal Papers* (New York, 1921), p. 295.

come to be increasingly dependent on the directions and guidance supplied by regulators. Severe limitations have been imposed on the traditional prerogatives of private management and control. The result has been divided responsibility. Regulated industries have two masters — the regulatory agencies and private management.

Is this an inherent defect of regulation? Is its necessary tendency to disperse managerial responsibility? Does regulation sap the vitality of industry by saddling it with rigid and inflexible standards? Is there a demonstrable loss of initiative and enterprise in regulated industries, or is regulation conducive to progressive management and hospitable to innovation? What are the precise responsibilities of private management under a system of regulation? Are the essential purposes of regulators and regulated necessarily hostile? Is an atmosphere of antagonism between them an integral and ineradicable characteristic of the regulatory process? Is regulation at best a halfway house between private and public enterprise, the result of an unstable compromise which seeks to combine the incompatible?

These and other similar questions this paper does not purport to answer. Nor can they be satisfactorily answered without a series of intensive case studies which analyze the experience of particular regulated industries in considerable detail. What has been suggested here is a general framework of analysis, which may provide perspective for such case studies. It is offered in the conviction that the process of regulation embraces more than the hierarchy of regulatory instruments, more than the pressure of particular interests, more than the institutional environment — that its essential nature lies in interaction among them all.

THE PROBLEM OF CONSTITUTIONAL DICTATORSHIP

Frederick M. Watkins

CONSTITUTIONALISM AND ABSOLUTISM

CAN dictatorship be made to serve the ends of constitutional government? Certainly the chances would not seem at the outset to be particularly bright. The very phrase "constitutional dictatorship" has a discouragingly paradoxical ring. The trouble is that dictatorship is just another word for absolutism. Many people have been distressed by the wastefulness of this apparent duplication, and valiant efforts have been made to distinguish between the two terms. But the fact is that a constant piling up of synonyms has always been one of the more characteristic features of political thought. After serving the needs of propagandists for a generation, even the hardiest word begins to show signs of fatigue. The only remedy is to adopt one that is new and relatively unspoiled. The result is that, in situations where our grandfathers would have seen despotism and tyranny, we now speak of dictatorship. This gives us a refreshing sense of discovery without the need for any corresponding freshness of thought.

But if dictatorship is simply another name for absolutism, it is hard to see what meaning can be attached to the term "constitutional dictatorship." Constitutionalism may be defined as a system of government whereby rulers are subjected to the restraining influence of law. Absolutism consists in the absence of such restraints. In the strictest possible sense, the two words are antithetical. Thus a phrase like "constitutional dictatorship" which tries to bring them together has all the earmarks of a particularly tiresome paradox. Experienced readers will be reminded of the clear but hollow tone so often found in the works of Mr. G. K. Chesterton. Without the Chestertonian wit as an accompaniment, no prospect could be more dreary.

It is true that there are certain defects, implicit in the very nature of constitutional government, which can be remedied only by a move in the direction of absolutism. The problem is one of efficiency. Perfect efficiency can never be insured without com-

plete freedom in the choice of ways and means. All contingencies are possible in a world of surprises, and ways of dealing with them must be similarly varied. The essence of constitutionalism lies, on the other hand, in the attempt to impose legal restraints upon rulers in their choice of political methods. In this respect there is, to be sure, a good deal of difference among constitutional states. In real life there is no such thing as pure absolutism or pure constitutionalism. No society has ever gone so far in formalizing political conduct as to make rulers purely and simply living mouthpieces of the law. And, at the other extreme, no government has ever been so nearly absolute that it could afford to pay no attention whatsoever to established legal principles. Actual political systems range all the way between the two extremes. But, even though there is no such thing as pure constitutionalism, it is perfectly possible for states to be more or less constitutional. The more constitutional they are, the more narrowly will their rulers be circumscribed by law. Legal restraints are bound at some time or other to stand in the way of effective political action. Other things being equal, it is clear, therefore, that absolutism will always tend to be more efficient than constitutional government.

Great care should be taken not to exaggerate the importance of this fact. When all is said and done, the only advantage of absolutism lies in its freedom from *legal* restraints, and law is by no means the sole, or even the most important, obstacle to effective political action. Of all political fallacies none is more deceptive, indeed, than the current tendency to confuse absolutism with omnipotence. If any single authority were in a position to accomplish its purposes without effective opposition, the whole problem of politics would at once become meaningless. Many people assume that this would be the position of any government freed from the trammels of constitutionalism. But the fact is that many a South American despot, with all his freedom from legal restraints, would give his right arm for the effective power possessed by a president of the United States. In one form or another, competitive struggles for power are bound to arise in any political system. If they cannot find expression in the forms of constitutional action, they will seek an outlet in the no less disquieting guise of conspiracies and purges. Absolutism has no magic to bring men rest from the eternal strife of politics.

The advantages of freedom from legal restraint are a good deal more obvious, moreover, from a short- than from a long-run

point of view. Other things being equal, it is true that the removal of constitutional restraints will tend to increase the effective scope and hence the potential effectiveness of government. What reason is there to suppose, however, that other things will be equal? Constitutional law is so intimately bound up with the whole social context that changes in that field can hardly fail to produce corresponding changes elsewhere. Peculiar dangers of bureaucratic stagnation and corruption are implicit, for example, in the restriction of public criticism which is characteristic of absolute regimes. But efficiency in government depends quite as much on the quality of administrative personnel as on the freedom of that personnel from legal restraints. What reason, then, can there be for supposing that the legal advantages of absolutism will not be more than counterbalanced by losses in other directions? Since many of these effects require a good deal of time before making themselves fully felt, the chances are that the immediate result of a move toward absolutism will be a net increase of efficiency. Long-run effects, on the other hand, are distinctly problematical. When taunted with the superior efficiency of totalitarian states, the supporters of constitutional government are at least justified in returning a Scottish verdict of "Not proven."

Societies cannot always afford, however, to adopt a long-run point of view. When a man is trying to save himself from falling off a stepladder, he is not likely to give much thought to the dangers of overexertion. When a social group is faced with an immediate threat to its existence, it also cannot afford to calculate in terms of a very distant future. Whatever its ultimate advantages may be, there are times when constitutionalism can no longer be tolerated as a basis for political organization. In the face of pressing dangers, any question as to the long-run consequences of absolutism becomes purely academic. There is no point in worrying about the future unless you are sure that you have a future to worry about.

The result is that, in countries where the conditions of survival are persistently severe, absolutism generally tends to become the normal form of government. All history goes to show that constitutionalism is strictly a luxury product, available only to those who enjoy a comfortable margin over and above the level of subsistence. In ancient Greece, for example, the forms of constitutional government were most successfully maintained in cities

like Athens and Sparta, which lay at the very center of the Hellenic world. This stands in striking contrast to the experience of border regions like Sicily, where democracy, under the constant threat of barbarian invasion, was constantly giving way to tyranny. A similar state of affairs is also to be observed in modern times. Prosperous countries, shielded from the worst rigors of post-war readjustment by a wide margin of economic safety, have tended to resist the advance of dictatorship. In this connection it is interesting to observe that the three richest colonial empires, Britain, France, and Holland, have all become notable as strongholds of constitutional government. Less well-endowed countries, like Italy and Germany, have become leading members of the opposing camp. Throughout history, experience has shown that permanent dissatisfaction with the conditions of existence will soon be followed by permanent absolutism.

It would be a mistake to suppose, however, that all threats to the life of societies are equally lasting in character. As a matter of fact, some of the most serious crises are also among the most short-lived. Foreign invasion and civil insurrection are two of the most obvious possible threats to the maintenance of an established social order; yet the backbone of foreign or domestic resistance is not infrequently broken in the course of a single battle. Famine and pestilence may bring a society to the brink of destruction and then withdraw as silently and mysteriously as they came. The same thing is true of those man-made pestilences known according to taste as business crises, depressions, or recessions. In a world of uncertainties, even bad news is not necessarily permanent. Temporary emergencies must therefore be reckoned along with lasting stringencies as one of the really important problems of political life.

CONSTITUTIONAL DICTATORSHIP AS AN EMERGENCY MEASURE

Now it is in connection with the problem of temporary emergencies, and in this connection only, that the possibility of constitutional dictatorship can ever be said to arise. Useful though absolutism may be from many points of view, it is always destructive from the standpoint of constitutional government. In the case of temporary emergencies, however, constitutional systems are brought face to face with a rather curious problem. The essential fact is that the institutions of constitutional govern-

ment, like so many other instruments of social order, are the product of gradual growth over a period of time. Constitutions are hardly worth the paper they are written on unless they rest upon a long accumulation of traditions and habits tending in the direction of free government. The instability of South American democracy is a well-known case in point. Decades and generations are needed for the development of a society able to support constitutional government. For the destruction of such a society, on the other hand, no great period is necessary. A single successful invasion or revolution may be quite enough for the purpose.

If it is used as a means of defense against movements of this character, absolutism may find itself in the paradoxical position of serving the long-run interests of constitutional government. Temporary emergencies are like permanent stringencies in that their immediate effect will be to throw constitutional principles into the discard. But if the resulting absolutism serves to protect established institutions from the danger of permanent injury in a period of temporary emergency, and is followed by a prompt return to the previous forms of political life, it is perfectly conceivable that the net result will be to increase rather than to decrease the effective span of constitutional government. Under these circumstances there is no reason why absolutism should not be used as a means for the defense of liberal institutions.

The essential problem of constitutional dictatorship is to give an established constitutional system maximum endurance in the face of temporary emergencies. Strict political conservatism is the true test of such a regime. Radical social and economic measures may, of course, be necessary as a means of preventing political change. During the Civil War, for example, President Lincoln found that his politically conservative purpose of preserving the Union could only be accomplished by the economically revolutionary step of freeing the slaves. Boldly inventive as it may be in other directions, however, a truly constitutional dictatorship must always aim at the maintenance of an existing *status quo* in the field of constitutional law. Deviations from the established norms of political action may be necessary for the time being. The function of a truly constitutional dictatorship is to provide such deviations and at the same time to make sure that they do not go any farther than is actually necessary under the circumstances.

Three basic criteria may be used, therefore, in distinguishing constitutional dictatorship from the various other forms of absolutism. In periods of temporary emergency, the problem is to find an absolute regime (1) which will be just sufficiently absolute to safeguard the interests of an established constitutional order, (2) which will continue in existence only so long as those interests are actually in danger, and (3) which will then be followed by an integral return to the previous constitutional system. A regime living up to these conditions would insure a minimum of permanent distortion in the face of temporary shocks. This may be taken as a definition of the ideal or limiting case of constitutional dictatorship.

Legitimate doubt may well be entertained as to the possibility of living up to these conditions in practice. Perhaps the unlikeliest feature of all is the notion of a complete return to previous political conditions after an interlude of more or less absolute government. The maintenance of any system of constitutional restraints is at best a difficult and precarious business. Men have a natural tendency to seek power in proportion to their own particular resources of energy and ability. If this tendency is to be kept within the limits of any fixed constitutional framework, some powerful inhibiting force must be provided. Experience shows that, under favorable conditions, the force of law may be great enough to attain the desired result. When the prestige of constitutional principles stands so high that any violation is sure to produce a dangerously unfavorable reaction on the part of powerful elements within the society, the most ambitious will be deprived of the capacity, and perhaps even of the desire, to obtain more power than is permitted under the existing legal system. All this depends, however, on the maintenance of law as a socially effective force. It is by no means easy to see how this can be reconciled with the fact even of temporary absolutism.

The trouble is that the social effectiveness of law depends in large measure on force of habit. Through constant repetition particular patterns of conduct become so familiar that conformity becomes a purely automatic response for a great majority of people. The provisions of constitutional law are patterns of this sort. But habits, in so far as they are based on repetition, have a tendency to break down in the face of any considerable change of behavior. Considering that absolutism is by definition a deviation from the established norms of constitutional action, it is clear

that dictatorship of any sort must serve in some measure to weaken the force of established institutions. Leaders soon grow accustomed to the exercise of unlimited power. Followers soon learn the ways of unquestioning obedience. In the strictest sense it is inconceivable, therefore, that a previous constitutional system should be restored in undiminished vigor after a period of emergency absolutism. Since this is one of the essential criteria of constitutional dictatorship, the only conclusion would seem to be that constitutional dictatorship is impossible.

To demand perfection in a matter of this kind would be, however, to set up a wholly false standard of judgment. Even though it may be true that constitutional dictatorship can never be fully realized in practice, this fact is not in itself enough to prove that the idea of constitutional dictatorship is for all practical purposes meaningless. The idea of a circle is not to be discarded simply because it is impossible to make a perfectly circular object. The circle has certain interesting properties never fully exemplified in reality, but frequently realized within useful limits of approximation. In the case of constitutional dictatorship, similar considerations ought to prevail. Since nature never runs to extremes, it is hardly to be expected that any absolutist interlude should ever be made perfectly serviceable to the cause of constitutional government. Our definition of constitutional dictatorship has been given in terms of an extreme or limiting case. The real question is not whether this limiting case can actually be attained but whether it can be approached within useful limits of approximation.

On this point a good deal is to be learned by considering the nature of law in general. The problem of securing flexibility in the face of exceptional situations is by no means peculiar to the constitutional realm. The purpose of all law is to impose fixed patterns of behavior upon the life of society. No fixed pattern can ever hope to be comprehensive enough to make adequate provision for all contingencies. Situations are always arising where rigid adherence to the norms of legal conduct would produce results of the most obviously undesirable character. Thus the need for temporary deviations from ordinary standards is common to law in all its phases. All legal systems of any great complexity have found it necessary to make arrangements dealing with that need. Pardons and amnesties in the field of criminal law testify to a universal recognition of the principle that some cases should

not be dealt with according to ordinary legal principles. On a rather less formal plane, judges, juries, and prosecutors also possess a number of discretionary powers which can be used to accord special consideration to circumstances not foreseen by established legal provisions. In the realm of constitutional law there is something strange and forbidding about the idea of emergency action. In the more familiar fields of legal action it is accepted quite as a matter of course.

The problem of constitutional dictatorship is very far from being so hopeless, therefore, as it would seem at first glance. When analogous problems are being solved every day in other fields of law, it is hard to believe that constitutional principles alone are incapable of achieving flexibility in the face of emergency needs. In all cases it is true that deviations from the norms of legal conduct cannot fail to involve a certain decrease in the habitual force of law. Every time a murderer is pardoned, new slayers gain the right to hope. All this is not fatal, however, unless the exceptions become so numerous as to form a new rule in their turn. Gross inadequacy in the face of unusual situations has been found in practice to be a good deal more damaging than flexibility as a threat to the prestige of established institutions. On the basis of manifest necessity some form of dispensing power has found a place in all legal systems. The problem of constitutional dictatorship is only a special instance of this more general problem. Paradoxical as the phrase itself may sound, there is every reason to suppose that an effective solution of the problem may ultimately be found to lie within the bounds of practical possibility.

THE EVIDENCE OF ANCIENT ROME

An appeal to analogous experience in other fields of the law may be all very well in its way. A single direct example is apt to be more convincing, however, than a hundred indirect analogies. This circumstance lends particular interest to the fact that a highly successful instance of constitutional dictatorship is to be found in the history of that very country to which we are indebted for our use of the word itself. Owing to the efforts of shrewd self-advertisers like Hitler and Mussolini, the idea of dictatorship has for some time been associated almost exclusively with opposition to the forms of constitutional government. It is therefore highly salutary to recall that the first men ever to bear the name of

dictator were officials of a fully constitutional state, the early Roman Republic. As a preliminary to investigating the conditions of effective constitutional dictatorship, we can do no better than to consider the actual experience of this, perhaps the most strikingly successful of all known systems of emergency government.

Constitutional ideals have seldom found more elaborate expression than in the early days of Rome. The ancient Romans, like the modern Britons with whom they are so frequently compared, were notable for a rare combination of legal conservatism and political inventiveness. Few people have ever been more fertile in the creation of new political institutions to meet the requirements of a changing situation. If Rome was able to outdistance all competitors in the race for mastery of the ancient world, her success was due quite as much to the superior brilliance and resourcefulness of her statesmen as to the prowess of her armies. But at the same time few people have ever been more tenacious in the maintenance of established legal forms. When the need for legal innovations was apparent, the Romans were always careful to supplement rather than to supplant existing institutions. Old organs of government were allowed to remain in operation long after their main functions had been assumed by newer authorities. The result was a peculiarly complex distribution of political functions. When the Republic was at its height Rome had, for example, no less than three separate legislative assemblies. Even the British never produced anything quite so alarming.

It was for the organization of executive functions, however, that the Romans reserved their more characteristic flights of ingenuity. Because of the fact that the previous government had been a monarchy, the founders of the Republic were particularly sensitive to the dangers of monarchical usurpation. The thought that some official under the new constitution might use his powers for the purpose of acquiring royal authority was constantly at the back of their minds. The structure of Roman constitutionalism was largely directed, therefore, to the task of confining the power of elected officials within the narrowest possible limits. This end was accomplished by the curious but effective device of establishing collegial magistracies. Whereas the supreme executive authority of the state had formerly been vested in a single monarch, this power was now divided between two new officials known as consuls. Since both were precisely equal in rank, the

orders of either consul were at all times subject to revocation by the authority of his colleague. This same principle of collegiality was also used in the establishment of lesser magistracies. By this means the founders of the Roman Republic hoped to prevent any one official from ever becoming powerful enough to threaten the stability of the new political system.

As time went on, the danger of monarchical usurpation grew rather less immediate. Distaste for strong executive authority remained, however, as a lasting influence on the course of Roman constitutional development. During the period of class warfare between patricians and plebeians, which formed the most serious crisis in the early history of the Republic, the power of the regular executive establishment was further limited by the creation of a whole new set of officials known as tribunes of the people. The function of these magistrates, ultimately ten in number, was to safeguard the interests of the plebeian class. In pursuance of that end each of them was authorized not only to veto legislative measures but also to prohibit the actions of other magistrates. Another institution of similar tendency was the right of provocation, whereby citizens were permitted under certain circumstances to appeal against the decisions of an official before an assembly of the people. The customary right of the senate to give advice on all important matters should also be mentioned as a significant limitation upon freedom of the regular magistrates. On the whole, it is probably safe to say that no constitutional system has ever been more distrustful of executive authority, or more fertile in devices for holding that authority within the narrowest possible limits.

The result of all this was to make Rome even more vulnerable than most constitutional states to the impact of temporary emergencies. Even under the most favorable circumstances a certain amount of difficulty was bound to arise in connection with a system vesting twelve or more separate individuals with an absolute veto in matters of public administration. The fact that interminable deadlocks did not constantly arise is in itself a tribute to the political sense and moderation of early Roman statesmen. In periods of unusual stress the situation often became intolerable. This was particularly apt to be the case in military crises. Because of the principle of collegiality, which applied in military no less than in civil affairs, Rome was regularly subject to the dangers of a divided military command. Armies might at any time be

called upon to conduct their campaigns under the direction of two consuls precisely equal in rank, each in a position to countermand all orders given by the other. Clearly the Romans were willing to sacrifice a good deal in the interests of political security. But the early Republic was almost constantly at war, and there were not a few occasions when the very life of the community seemed to depend on maximum military efficiency. This could not be had so long as the regular constitutional structure remained in force. The result was to bring Rome face to face at a very early period with the need for constitutional dictatorship.

With characteristic directness, the Romans met the problem of temporary emergencies by establishing a temporary magistracy. Dictatorship was the name given to this extraordinary office. The distinguishing characteristic of the institution lay in the fact that this, alone among the early Roman magistracies, was intended purely and simply as an emergency resource. Whereas most of the regular officials were elected for a one-year term, the dictator was appointed for six months only, and the further extension of that time was prevented by an express provision that there might not be more than one dictatorship in any single year. Instead of being elected at fixed and regular intervals, moreover, dictators were appointed only on occasion and in response to unusual situations. The initiative in such matters lay entirely with the senate. Whenever things seemed to be getting too difficult for the regular officials, it would advise the appointment of a dictator. Acting on this advice, the consul to whom it had been given would proceed immediately to the selection of some appropriate person, usually an elder statesman of consular rank, for elevation to that office. This nomination would then be submitted, more or less as a formality, for confirmation by the centuriate assembly. By this comparatively simple procedure, which might well be completed in a day or two, the Republic could at any time be provided with a temporary government capable of dealing with all temporary emergencies that were likely to arise.

The essential purpose of dictatorship was to set up a monarchical authority within the framework of the Republic. Alone among early Roman magistrates, the dictator had no colleague to oppose his actions. Since the consuls and other regular officials were automatically relegated to a subordinate position, the result of establishing a dictatorship was to concentrate all executive functions in the hands of a single man. Nor was the principle of

collegiality the only restraint from which the dictator was relieved. His acts were exempt from the intercession of the tribunes and from the right of provocation. Even the advisory control of the senate was relaxed in his case to a quite unusual degree. This is not to say that the powers of a dictator were absolutely unlimited. In financial matters, for example, he was entirely dependent on the senate, whose consent was necessary for the withdrawal of funds from the public treasury. It is also significant that his authority was conceived primarily in terms of military command. A dictator enjoyed no legislative powers, and was never concerned with civil jurisdiction. This limitation was comparatively unimportant, however. The wide scope of military authority in periods of difficulty made it possible, particularly in a state so strongly militarized as ancient Rome, to intervene in all the more important phases of social life. Thus the powers exercised by a dictator in time of need were practically monarchical in character.

The emergency resources thereby created were not by any means permitted to be idle. Throughout the first three centuries of the Republic, dictatorships were inaugurated with the greatest possible freedom. Eighty-eight are supposed to have occurred during this period, which means that one must, on the average, have appeared every three or four years. Occasions for the use of dictatorial authority were various. Crises arising in the course of foreign warfare were perhaps the most usual. It was as dictators that Cincinnatus and other real or semi-legendary heroes of the Republican epoch performed some of their most celebrated military exploits. But, even though this was at all times the real core of dictatorial action, use of the magistracy was not confined to emergencies of this particular sort. Civil insurrection may be no less serious than foreign invasion as a threat to the life of a state. In the period of conflict between patricians and plebeians, when Roman unity hung dangerously in the balance, dictatorship was often able to show its value as an instrument for the suppression of civil disorders. Similar opportunities arose in other crises. In no case was there any hesitation about making use of the available emergency powers.

At the present time many people would be tempted to regard so extensive a reliance on absolutist methods as a sign that constitutional government was about to collapse. It is for that reason particularly interesting to find that the use of dictatorship was an early rather than a late phenomenon in the life of the Roman

Republic. The first dictatorship is traditionally ascribed to the year 501 B.C., less than a decade after the expulsion of the kings. The fifth and fourth centuries, which saw the foundations of Roman greatness being laid, were also the period when dictatorial authority was most frequently invoked. During the third century, on the other hand, the institution was used rather less freely, and by the end of the Second Punic War it had wholly disappeared from Roman constitutional practice. When Fabius Cunctator was sent to rally the Roman armies after Hannibal's crushing victory at Lake Trasimene, he was armed with dictatorial authority. The even more overwhelming disaster of Cannae brought yet another dictatorship in the following year. This was the last important use ever made of the ancient magistracy. From the year 202 onward, without ever being formally abolished, the office was allowed to suffer complete neglect. Far from ushering in a period of constitutional collapse, dictatorship itself disappeared at a time when the Republic was still at the very height of its vigor.

The value of the institution from a purely constitutional standpoint is nowhere more clearly apparent, moreover, than in the circumstances which led to its ultimate abandonment. So long as Rome was a truly constitutional state, dictatorship remained an indispensable resource. Such was the case during the first three centuries of the Republic, when the maintenance of an effective separation of powers stood as a very real limitation upon the legal competence of any single organ of government. Toward the end of the third century, however, the senate began to assume a dominant position in the political life of Rome. Institutions designed to fill the needs of a small city state were increasingly inadequate for the purposes of a world empire. The result was that, although the forms of constitutional government were rigorously preserved, the regular magistrates fell more and more regularly into the habit of depending on the senate for advice. The final consequence was something not very far removed in practice from senatorial absolutism. With political authority thus effectively concentrated in the hands of a single body, there was no longer any problem of securing unified action in periods of emergency. The abandonment of dictatorship at this particular time is thus in itself a significant symptom of diminishing constitutional vitality.

From our standpoint the early disappearance of dictatorship is

a matter of considerable importance, for it serves to free the institution from any trace of responsibility for the ultimate collapse of the Republic. It is true that the ancient magistracy enjoyed a brief titular revival in the course of the first century B.C. At the height of their power Sulla and Caesar both ruled as dictators, and it cannot be denied that their activities in that position did much to prepare the way for absolute monarchy. This provides an interesting precedent for our present use of the term "dictatorship" in connection with men like Hitler and Mussolini. But these late figures are connected with the dictators of early Rome by nothing more substantial than the name itself. Whereas the earlier magistrates had been limited to a term of six months, and had received no grant even of ordinary legislative powers, the later dictators held office practically at their own discretion, and were vested not only with legislative but even with constituent powers. Sulla, who was appointed for an indefinite period and actually remained in office for some three years, was expressly authorized to revise the constitution. It is entirely probable that Caesar, who died in the enjoyment of a life dictatorship, was vested with powers no less comprehensive in scope. In view of these glaring differences, it is clear that constitutional precedents contributed little or nothing to the practice of first-century dictatorship. Despite the revival of its name, the ancient magistracy had nothing to do with the later developments of Roman constitutional history.

The experience of ancient Rome is important, therefore, as a demonstration of the fact that a reasonably effective solution can be found to the problem of constitutional dictatorship. For almost three hundred years government of the most elaborately constitutional character was repeatedly alternated with interludes of extreme absolutism. The net result was to increase rather than to impair the stability of the Republic. Such is the verdict of all commentators on early Roman history, who are unanimous in agreeing that dictatorship was one of the most successful elements in a constitutional system more than ordinarily rich in ingenious devices. Constitutional principles are like other forms of law in requiring a certain degree of flexibility. The history of Rome shows that the satisfaction of that need is at least potentially compatible with the maintenance of an effective constitutional morality. Across the ages this comes as an instructive lesson in the principles of constitutional government.

CONDITIONS OF SUCCESS

The experience of ancient Rome shows that constitutional dictatorship is a practical possibility. How then can this success be duplicated in other constitutional states? Granted that even under the best of circumstances an absolutist interlude is bound to be somewhat disturbing to the stability of constitutional government, the important thing is to prevent that disturbance from assuming permanently destructive proportions. A good deal depends on the intrinsic vigor of the constitutional system itself. The firmer the roots of constitutional government, the greater the strain it will be able to stand without suffering permanent distortion. Much of the success of dictatorship in ancient Rome was due to the fact that the republican tradition in general was particularly strong in that country. But if the stability of constitutionalism depends in part on its own inherent vitality, much also depends on the severity of the stresses to which it is subjected. The effectiveness of emergency institutions should be judged according to their success in minimizing the inevitable strain. What are the conditions tending to lessen the destructive effect of temporary absolutism? From the standpoint of practical politics, this is the real problem of constitutional dictatorship.

The first important condition of success is as follows: *The period of dictatorship must be relatively short.* This proposition is more or less self-evident. As a matter of fact, it is implicit in everything we have already been saying about the habitual nature of law in general and of constitutional law in particular. Habits have a considerable capacity for persistence even under the most adverse circumstances. But if action begins to take place along novel lines, it is only a question of time before this in turn becomes a basis for the formation of new habits. This is just as true in the field of law as in any other form of human activity. The longer a period of absolutism may be, the greater the probability that it will undermine the vitality of existing constitutional traditions. Continued beyond a certain point, therefore, dictatorship can no longer be reconciled with the maintenance of constitutional government.

Unfortunately, the location of this point cannot be defined in precise and general terms. In ancient Rome interludes of emergency absolutism were limited to a period of six months each, but there is no reason to regard this as a divinely appointed maximum.

Societies differ a good deal in their tolerance for emergency measures. In regions where constitutional usages are not very firmly rooted, the slightest deviation from normal methods may be enough to upset an already uncertain equilibrium. In regions where those usages are more firmly established, a dictatorial interlude might last perhaps for several years without disastrous consequences. Questions of the sort cannot be discussed profitably without reference to the conditions of a particular time and place. As a general rule the best we can do is to say that the ultimate restoration of constitutional government will tend to be difficult in proportion to the length of time during which it has ceased to be in effective operation. The shorter the period of deviation, the greater the chance of a reasonably close approximation to the requirements of constitutional dictatorship.

A second major condition of success is as follows: *Dictatorship should always be strictly legitimate in character.* This proposition is also self-evident, once the general nature of law is taken into consideration. In modern societies law is not necessarily a matter of long-established usage. It may also be the result of deliberate legislative enactment. The effectiveness of legislation has its limits. But, so long as they do not run grossly contrary to existing moral standards of the community, new laws may become an immediate social force, provided only that they emanate from a legislature or from some other organ of government generally recognized as having legislative authority. Habitual respect for the promulgating authority takes the place of habitual respect for the law itself in cases of this sort.

All this bears directly on the problem of constitutional dictatorship. In situations which tend to weaken the habitual basis of most political processes it is all the more important to maintain the prestige of established political authority. If the powers of a dictator are derived from a constitutional source of undoubted legitimacy, the habit of respecting the constitution will remain unbroken. But if temporary absolutism is introduced on the basis of usurpation, without the sanction of any legitimate authority, the vitality of constitutional principles will be doubly weakened in the process. The shock can only be reduced to a minimum by insuring that the emergency concentration of powers be accomplished, not by extra-constitutional action, but by an appeal to definite provisions antecedently embodied in the framework of the constitution itself.

This was the fortunate state of affairs existing in Rome during the first three centuries of the Republic. Although constitutional government was cherished as the normal basis of political action, the constitution itself made provision for an alternative system of the most thoroughgoing absolutism. The application of this alternative system in time of need was regulated by a procedure so clear-cut and definite that there could never be any doubt as to the legitimacy of any given emergency regime. The authority of the dictator was no less constitutional than that of the regular magistrates. In this way it became possible to gain the advantages of temporary absolutism without giving the highly dangerous impression that law itself had ceased to command respect. The principle here involved is one which cannot safely be disregarded by any constitutional state concerned with the problems of emergency action.

So far as the maintenance of constitutional tradition is concerned, these are the two main conditions of successful dictatorship. Absolutist interludes of the most extreme character are necessary from time to time. In the case of relatively unstable constitutional systems, the resulting strain is apt to prove fatal. But so long as the interlude is brief and involves no violation of legitimacy, there is no reason why the strain should exceed the limits capable of being borne by a constitutional state of reasonable vitality.

This is only the first phase, however, in the problem of constitutional dictatorship. Important as the first two conditions may be, they can hardly be said to touch the heart of the matter. It is true that an absolutist interlude which is at once brief and legitimate will tend to be relatively harmless. But the avoidance of harm is at best no more than a negative virtue. The main function of constitutional dictatorship is to do positive service in the cause of constitutional government. If this end is to be achieved, it is necessary that emergency powers, however harmless in themselves, should be invoked only on occasions when a still greater impairment of normal political methods cannot otherwise be avoided. The important thing, returning to an earlier statement of the matter, is to find an absolute regime which will be just sufficiently absolute to safeguard the interests of an established constitutional order, which will continue in existence only so long as those interests are actually in danger, and which will then be followed by a complete return to the previous constitutional sys-

tem. Legitimate powers needlessly invoked, if only for a short period of time, or needlessly prolonged beyond the real crisis, would bear no relation to the requirements of constitutional dictatorship.

Unfortunately there is no choice in deciding matters of this sort but to rely on the personal judgment of fallible human beings. Danger appears in so many different guises that there can be no hope of setting up hard and fast rules for identifying it. To determine the exact amount of emergency action needed at any given moment is a matter of such complexity that wholly accurate results are quite out of the question. If constitutional dictatorship is to be approached even within reasonable limits of approximation, the power of decision must be left in the hands of persons gifted with an unusual degree of political experience and judgment.

Considering that the problem of securing able rulers is one of the most difficult and far-reaching in the whole boundless repertory of unsolved political riddles, it would be presumptuous to do more than mention the matter here. Limitations of ability are not the only obstacles, however, to a proper application of emergency measures. Although dictatorial powers may often be misapplied through honest error, there is also a possibility that they will be willfully abused. Temporary absolutism can be put to many uses other than the legitimate defense of constitutional government. Constitutional limits bar the road to all sorts of aspirations. The temptation to disregard those limits is correspondingly broad. The judgment of those responsible for the use of emergency powers is likely, therefore, to be biased by many considerations irrelevant from a truly constitutional standpoint. To prevent this factor from assuming unduly dangerous proportions is the second and in some respects the more important aspect of the problem.

This brings us to the third and last condition for the success of constitutional dictatorship: *Final authority to determine the need for dictatorship in any given case must never rest with the dictator himself.* The reason for this condition will be readily apparent to anyone at all familiar with the nature of political power. Useful as temporary absolutism may be, there could be little hope for the lasting success of a constitutional system which gave any man the unrestricted right to assume special powers "in time of serious emergency." Whenever his own desires are thwarted, an energetic

person is soon convinced that the foundations of society are crumbling. Life resolves itself into a perpetual state of emergency. The grant of unlimited dispensing power is very apt, therefore, to mean the end of constitutional government.

The creation of the modern nation state is an interesting case in point. The political system of the Middle Ages was essentially constitutional in character. Under a legal system of quite extraordinary complexity, the rights and duties of government were distributed among a large number of independent authorities. But this elaborate structure of vested interests had one crucial weakness. As a result of the persistence of doctrines handed down from the days of later Roman absolutism, princes as distinguished from the great lords, chartered towns, and other organs of medieval constitutionalism were widely recognized as having a discretionary right to dispense with the law in unusual situations. This unlimited right (*plenitudo potestatis*) became a matter of the greatest significance when the end of the Middle Ages brought a revival of the trend toward political absolutism. In order to nullify the vested rights of their adversaries, princes had simply to assert their right of suspending normal legal principles in cases of individual need. Unusual situations became so frequent that permanent courts, like the Star Chamber Court in England, were set up to exercise the princely prerogatives. Against these tendencies, the medieval constitutional structure offered no legal means of defense. Right or wrong, the prince had final authority to decide whether exceptional measures were or were not justified in any given circumstance. The result was a complete centralization of state authority at the expense of established constitutional principles.

All this stands in striking contrast to the practice of the early Roman Republic. There everything was done to prevent self-interest from entering into decisions as to the necessity for emergency action. The inauguration of dictatorship rested not with the prospective dictator, whose judgment might be warped by ambition, but with the senate and consuls. Considering that their authority was drastically curtailed during the ensuing period, it was only natural to suppose that they would be careful not to invoke emergency powers needlessly. Once those powers had actually been granted, it was left to the discretion of the dictator, within certain limits, to determine how long they should continue in operation. In the days of true republican vigor it was a matter

of honor to surrender dictatorial powers as soon as possible, speed being a sign of commendable efficiency in the performance of an appointed task. But if the dictator should nevertheless be tempted to keep office longer than necessary, the provision that no dictatorship should in any case last more than six months stood as a safe guarantee against the grossly excessive prolongation of emergency powers. Altogether, the Roman constitution showed remarkable ingenuity in keeping the ultimate power of decision from falling into the hands of anyone personally interested in the abuse of that power.

It goes without saying that these particular arrangements were suited only to the needs of this particular constitutional state. The rigid inflexibility of a six-months' time limit was only feasible, for example, because of the fact that summer was the customary season for military campaigns in early Rome. The probable duration of future crises can seldom be calculated so accurately in advance. In most states it will be found, therefore, that something a good deal more flexible will be needed in the way of dictatorial resources. In this connection it is interesting to note that the ancient Roman office of dictatorship fell into disuse at the precise moment when the military needs of the Republic began to be less readily calculable. With the defeat of Hannibal, Rome entered upon her career as a Mediterranean power. Overseas conquest called for military campaigns lasting a good deal longer than six months. This change did much to render the old form of dictatorship obsolete even under the conditions of the later Roman Republic. Most constitutional states would find similar arrangements equally unsuitable.

Fortunately there is no logical limit to the number of devices available for checking the abuse of dictatorial discretion. If the activities of a dictator are at all times effectively subject, for example, to review by some independent organ of government, there is no reason why fixed time limits should be necessary at all. Under these conditions it might even be desirable to allow the dictatorship to begin and end on the initiative of the dictator himself. The existence of an effective external check is the only really indispensable requirement. Without this safeguard against abuse there can be no assurance that emergency powers will be used in a manner even roughly serviceable to the cause of constitutional government.

Thus the problem of constitutional dictatorship falls into two

quite separate parts, the problem of power and the problem of limitations. If constitutional states are to deal with temporary emergencies at all adequately, it is necessary on the one hand that the government should be given emergency powers sufficiently broad in scope to cover all probable contingencies. But, if these powers are to be of any real use, it is also necessary that stringent limitations be provided against possible abuses. Neither side of the question can be neglected without danger.

The purpose of the present chapter has been to show that neither aspect is intrinsically incapable of solution. So long as they are strictly temporary and legitimate, powers of the most absolute character can safely be incorporated within the structure of any fairly vigorous constitutional state. So long as the ultimate right of decision rests with someone other than the dictator himself, the danger that those powers will be abused can be kept within tolerable bounds. It is true, of course, that these two sets of conditions are to some extent mutually inconsistent. If the discretion of a dictator were limited at all points by subservience to a higher authority, he would cease for all practical purposes to have any value as an independent agent, and his power would be inadequate even to the simplest emergency needs. Conversely, the question of limitations would suffer from any attempt to insure perfect adequacy of power. But even though the two principles stand in partial conflict, the example of ancient Rome shows that an effective working compromise is by no means beyond the bounds of possibility. Through a wise combination of imperfectly compatible elements, the problem of constitutional dictatorship can be solved within useful limits of approximation. It is by their success in reconciling the hostile claims of power and of security that the excellence of emergency institutions ought properly to be judged.

THE STATE OF SIEGE AND MARTIAL RULE

In the practice of modern constitutional government, the need for constitutional dictatorship has found ample recognition. Few people are aware, indeed, of the extent to which liberal countries have been willing to go in this direction. The dictatorship of early Rome is usually treated as a unique product of Roman political genius. Only on the rarest occasions is there any suggestion that comparable arrangements might be found to exist in modern

times. But the fact is that a distinct need for constitutional dictatorship, in one form or another, is common to all constitutional systems. Contemporary states may not be faced with the particular forms of emergency breakdown to which the ancient Republic happened to be subject. Collegial magistracies and tribunician vetoes have no exact counterpart in the government of today. But even though the modern constitutional state relies on a quite different set of devices for the limitation of political power, this mechanism in turn is no less subject to strain in the face of temporary emergencies. Awareness of this fact has led in modern times to the development of emergency institutions which tend if anything to be rather more extreme than the dictatorship of ancient Rome.

The basic problem of constitutional dictatorship is to increase the effectiveness of *executive* action. Temporary emergencies may cause an occasional breakdown in the legislative functions of government.[1] The strain of exceptional circumstances is much more apt to be felt, however, by administrative than by legislative authorities. Since the primary task of legislation is to deal with the long-range problems of society, it is entirely possible for a temporary emergency to come and go without necessitating any sort of legislative action. The task of administration, on the other hand, is to deal with specific situations as they arise from day to day. This means that in the case of temporary emergencies primary responsibility will usually be found to rest upon the administrative authorities. The main task of constitutional dictatorship is therefore to provide freedom in the realm of administration. For the sake of convenience this may be defined as the problem of administrative dictatorship. Dictatorship in early Rome was exclusively administrative in character. In modern times the need for administrative dictatorship has been similarly recognized in all constitutional states.

On this point it is possible to speak not of this or that particular state but of constitutional states in general. Nowhere, indeed, are the underlying uniformities of political liberalism more strikingly apparent than in connection with the problem of constitutional dictatorship. Superficially there is a good deal of difference among the various constitutional states of modern times. Some are monarchies and others republics. Some are federal, others unitary states. Some follow the presidential, others the parliamentary

[1] For more elaborate treatment, see pp. 358ff. below.

pattern of executive responsibility. But important as these and other differences may be, the fact remains that all these political systems are united by more than a trace of family resemblance. Considering that nineteenth-century liberalism was a world movement inspired by common political ideals, this circumstance is not particularly surprising. In order to prevent any absolutist concentration of powers within the government itself, all liberal countries rely in the first instance on a tripartite separation of functions between executive, legislative, and judicial organs of government. In order to prevent any undue interference with private citizens, all liberal countries make provision for some sort of bill of rights, each of which proves upon examination to be remarkably like its fellows. These uniformities are reflected in the practice of administrative dictatorship.

Some differences are to be found between the emergency institutions of various modern countries. We shall find that these differences are particularly striking when we pass from the English-speaking world, with its common law system of jurisprudence, to the other areas of modern constitutional government, with their civil law system. But in their treatment of the problem of administrative dictatorship all these countries are characterized by a considerable degree of basic agreement. Because of their marked structural uniformity, all have tended to show the same general weaknesses in the face of temporary emergencies. The result is that all have been forced to follow much the same path in developing emergency institutions.

In civil law countries the principal legal basis for constitutional dictatorship is provided by the so-called "state of siege." The institution originally developed, as the name itself implies, out of the practice of conferring plenary powers upon the commander of a besieged fortress. During the course of the nineteenth century it was gradually extended to other situations where the maintenance of established political authority was seriously threatened. The state of siege first appeared in France at the time of the Revolution, and spread with the adoption of modern constitutionalism to practically all the countries not included within the English-speaking world. In the course of its migrations the institution has assumed many different forms and adopted many high-sounding aliases. But, for all their superficial dissimilarities, few of the states of siege, states of emergency, and states of alarm now scattered over the face of the earth have really deviated in

any essential particular from the original French prototype. For the sake of brevity we may be content, therefore, to consider the institution primarily in the light of French experience.

The state of siege in its present form is a device fully adapted to the needs of modern administrative dictatorship. In constitutional governments of the liberal stamp, the main checks on administrative action are to be found in the bill of rights, in the independence of the judiciary, and in the principle of federalism. The function of the state of siege is to remove the more irksome of these restraints in periods of foreign invasion or of armed insurrection. The legal basis of the institution is to be found in the law of August 9, 1848, as supplemented and amended by the law of April 3, 1878. An examination of these two crucial pieces of legislation will show that little or nothing has been omitted that might conceivably contribute toward the effectiveness of dictatorial action in the field of administration.

The automatic suspension of certain civil liberties is the first and perhaps the most important consequence of declaring a state of siege. Freedom of the press and freedom of assembly are abolished, and the responsible authorities are empowered to banish undesirable persons from the affected regions, to institute searches, and to seize all implements of war. All this is in violation of provisions normally guaranteed by French law. Respect for these legal provisions has been found to be incompatible, however, with the fullest degree of efficiency in the conduct of military operations. Temporary suspension of the rights in question has therefore been included as one of the more significant features of the state of siege.

The second main consequence of the state of siege is to transfer all powers relative to the maintenance of public order from the civil to the military authorities. This provision, eminently natural in view of the fact that the institution was essentially military in its origins, is important primarily as a means of increasing the unity of administrative action in a time of emergency. In view of the fact that the army, of all organizations in the modern state, is the one most rigorously disciplined in obedience to a unified command, it is clear that any move to expand the functions of the military must be a move toward administrative centralization. This is a crucial matter from the standpoint of administrative dictatorship.

In connection with the modern constitutional state the question

is, to be sure, a good deal less important than it was in the days of ancient Rome. In comparison with the collegial organization of the early Republic, the administrative structure of the modern state, both in its civil and in its military aspects, is even in normal times a triumph of hierarchical centralization. The need for an emergency concentration of administrative powers is correspondingly less acute in modern than in ancient times. This is especially true in the case of a highly centralized country like France. In countries like Switzerland or pre-war Germany, on the other hand, this aspect of the state of siege is a matter of very real importance. Federalism breaks up the unity of administrative action by guaranteeing a certain area of independence to local agencies of government. Under these conditions, the transfer of political functions from the civil to the military authorities has a distinctly centralizing effect, for the army in such states is almost always subject to the undivided control of the federal authorities. This is an important function of the state of siege in all federal systems. Even in unitary states like France, moreover, the civil establishment is never quite so thoroughly disciplined as the military. Because of this fact, a certain increase in the unity of administrative action is involved in any extension of military at the expense of civil authority. This is at least potentially significant from the standpoint of administrative dictatorship in countries of this sort.

The third great consequence of the state of siege is to relieve the administration from restraints normally imposed by an independent judiciary. Upon the establishment of an emergency regime in France, the regular courts are automatically deprived of their competence to deal with offenses against the public order. This function is taken over by special military tribunals acting under particularly summary rules of procedure. The assumption of judicial functions by a body so essentially executive in character clearly violates one of the basic elements in the modern doctrine of the separation of powers. The operation of constitutional government rests in modern times to a very large extent upon the maintenance of an independent judiciary capable of testing governmental action in accordance with professional standards of competence and impartiality. This is true in France no less than in other parts of the liberal world. In a period of serious emergency considerable inconvenience may result, however, from the delays and uncertainties implicit in the operation of an inde-

pendent judicial establishment. The transfer of judicial functions to administrative authorities is for that reason an essential feature of administrative dictatorship in any liberal state. Through the operation of the state of siege, this result is achieved in France and in most of the other countries which follow a civil law system of jurisprudence.

In common law countries, which form the second main seat of contemporary liberalism, similar results are achieved through the use of martial rule. To give any exact definition of this institution would be a quite impossible task, for the whole matter is characterized by a degree of vagueness incredible to anyone unacquainted with the spirit of Anglo-American jurisprudence. Legal systems of this family are distinguished from those of a civil law persuasion by a marked preoccupation with something known as "the reign of law." Martial rule is nothing more than a special application of the general common law principle that, whenever the reign of law is interrupted by a display of illegal force, it is the duty of all citizens, including government officials, to take all necessary steps for the restoration of legitimate authority. "Reasonable necessity" is the only recognized test for determining the legitimacy of actions taken on this basis. To ask people to decide what is or is not reasonably necessary under various circumstances is obviously to invite the widest differences of opinion. The resulting uncertainties are so great that some authorities have gone so far as to conclude that there is no such thing as a law of martial rule. But even though the legal incidents of martial rule are much less clearly definable than those of the state of siege, there can be no doubt that this is a recognized emergency resource with important legal consequences. On this basis the executive officials of England and America are able in time of need to act with quite as much freedom as their brethren on the continent of Europe.

To begin with, it would be hard to point to any major civil liberty that has not at one time or another been successfully set aside in the name of martial rule. Legislation dealing with the state of siege always makes it a point to state definitely which parts of the bill of rights may and which may not be interfered with. Under the common law, on the other hand, no attempt is made to specify the rights which may be suspended in time of need. This leads on occasion to measures of the most extreme character.

Perhaps the most interesting cases in point are to be found in the periods of industrial warfare which have occurred from time to time in various parts of the United States. During the Colorado mining troubles of 1903–04, for example, freedom of the person and of property, to say nothing of less spectacular liberties like the freedom of speech, press, and assembly, were repeatedly violated by the military authorities. Public meetings were prohibited, newspapers were suppressed or subjected to a drastic censorship, saloons and non-union mines were forcibly closed. "Undesirable persons" were expelled from the district or held without trial by authority of the local military commander. All this was accomplished, moreover, without any essential violation of legal rights. After his release one of the labor leaders who had been detained without trial sued the responsible authorities. His claims were rejected by a unanimous Supreme Court, which, speaking through the person of no less celebrated a liberal than Mr. Justice Holmes, declared that "when it comes to a decision by the head of the State upon a matter involving its life, the ordinary rights of individuals must yield to what he deems the necessities of the moment." [2]

Although there has been no occasion in recent times for an equally drastic use of martial rule in England, a good deal has been done along these lines in various dominions and colonies. The action of British courts in reviewing these emergency measures has uniformly gone to show that the same general principles apply in other parts of the English-speaking world. Martial rule is no less effective than the state of siege, therefore, as a means of freeing administrative authorities from the restraint of civil liberties.

Another frequent incident of martial rule is the transfer of judicial functions from the regular courts to special military tribunals. Known in the British Empire as military courts and in the United States as military commissions, these bodies form a well-recognized element in the common law repertory of emergency action. In purely civil suits they are not recognized as having any sort of authority. In the field of criminal law, on the other hand, they enjoy the broadest powers to do "with any forms and in any manner, whatever is necessary to suppress insurrection, to restore peace and the authority of law." [3] Considering that

[2] *Moyer* v. *Peabody*, 212 U. S. 78 (1909).

[3] J. F. Stephen, *History of the Criminal Law* (London, 1883), I, 216.

their only limitation is the rule of reasonable necessity, it is obvious that they are if anything rather freer than the corresponding bodies to be found in civil law countries.

In federal systems martial rule may also serve, in much the same way as the state of siege, as a means of overcoming difficulties implicit in the distribution of functions between central and local organs of government. During the Civil War in America it was frequently used for this purpose, not only in enemy territory but also in the doubtfully loyal border states. A notable instance of the latter sort occurred in the opening days of the conflict, when the passage of federal troops through Baltimore became the occasion for seriously hostile demonstrations. Local officials met this threat to the public peace in a somewhat novel manner. Acting on the assumption that unpleasant incidents would be less likely to occur if the army kept out of the city, they decided to dynamite the railroad bridges leading to the front. Under these circumstances the responsible military commander felt called upon to intervene in the name of the federal government. On the basis of martial rule, local police commissioners were deprived of their functions, and responsibility for maintaining order in the district was assumed by the military authorities. To the extreme proponents of states' rights this action seemed outrageous at the time. Few people would now care, however, to challenge its propriety. The doctrine of reasonable necessity would seem to justify the infringement of federal rights no less easily than the transfer of judicial powers to executive tribunals or the violation of civil liberties. In federal countries this is apt to appear as one of the more significant features of martial rule.

So far as the extent of emergency authority is concerned, therefore, the institutions of modern administrative dictatorship leave little or nothing to be desired. Through the state of siege or martial rule, every liberal government is provided with a means whereby all the more hampering restraints upon administrative action may be suspended in time of emergency. But the foregoing discussion has already shown that there are two essential parts to the problem of constitutional dictatorship, the problem of power and the problem of imposing limitations upon that power. Ancient Rome achieved a very remarkable degree of constitutional stability by providing a drastic emergency power and surrounding it with equally drastic checks. Modern constitutional governments have been no less generous in their recognition of the need for dicta-

torial authority. It remains to be asked whether they have been successful in subjecting that authority to legal restraint.

In civil law countries the need for an independent check on the discretion of dictators is met primarily through reliance on the legislature. Before the state of siege can be invoked in France, both houses of parliament must ordinarily vote their approval. It is true that there are certain exceptions to the general rule. Considering that a modern national legislature, as distinguished from the senate of ancient Rome, cannot always be convened and made ready for action at a moment's notice, prior legislative action has occasionally to be waived in cases of sudden emergency. The French constitution, accordingly, permits the state of siege to be inaugurated by executive decree during those periods when the legislature is not in session. But this marks no essential deviation from the principle of legislative control. In all such cases it is expressly provided that parliament must reassemble within three days. If the necessary legislation is not then forthcoming, the state of siege is automatically brought to a close. Even after it has been authorized, moreover, an emergency regime may be terminated at any time and without notice by a simple vote of the legislature. Other civil law countries follow principles of much the same general character. By giving the legislature ultimate authority over the inception and termination of emergency powers, it is believed that the executive can be kept from any very serious abuse of dictatorial discretion. This is the civil law solution to the problem of administrative dictatorship.

At first glance this would seem to be a highly satisfactory way of dealing with the matter. Under the conditions of modern constitutional government there is bound, however, to be a certain element of unreality in any scheme which relies upon legislatures for the limitation of administrative dictatorship. The trouble is that modern legislatures are not for the most part really distinct enough from the executive organs of government to serve as an independent check upon their movements. It is true that the separation of legislative and executive powers is commonly described as one of the basic principles of constitutional government. But the fact is that, through the operation of party politics, powers kept distinct in form are often subject in practice to a considerable degree of reintegration. When effective control both of the executive and of the legislative branches of government rests with a single political party, or with a more or less unified coalition

of parties, the possibility of using one to check the other is very largely diminished. Under the parliamentary system of cabinet responsibility, which plays so large a part in modern constitutional practice, this is regularly the case. Even in countries with a presidential executive control by a common party organization is rather more likely than not. The amount of reintegration resulting from this situation depends on the degree to which the ruling party or coalition is united by an effective common discipline. This varies from country to country, and from time to time in the same country. In all cases, however, the chance of some such development is at least great enough to throw doubt upon the practical availability of legislatures to serve as an independent check upon the exercise of administrative authority.

These misgivings are particularly pertinent in connection with the problem of administrative dictatorship. Unscrupulously used, the state of siege and martial rule are both capable of developing into powerful party weapons. Under the stress of electoral competition, common party interests are often to be served by depriving citizens of their constitutional rights to freedom of speech and of the press. There is also a certain obvious appeal involved in any proposal for the suspension of local or judicial officials who happen to support a rival political organization. Such are the means always used by authoritarian governments in the well-explored art of "making" elections. Under the conditions of modern constitutional government there will always be a similar temptation to use emergency powers for unfairly partisan purposes. In view of the fact that all stand to gain by a common party victory there is no reason to suppose that the rank and file will be any less complaisant than their leaders toward abuses of this particular character. Where common party interests are at stake, therefore, it is clearly unrealistic to rely on a government-controlled majority in the legislature to exercise effective supervision over that same government in its use of emergency powers.

When the government majority itself is not particularly unified, internal dissensions may stand in the way of any vigorous exploitation of dictatorial possibilities. The prevalence of loose coalition governments in France has no doubt been one of the factors contributing to that country's relatively satisfactory record in connection with the state of siege. But strongly disciplined parties are an important and increasingly characteristic feature of the modern constitutional state. Legislative checks accordingly

leave much to be desired as a practical instrument for the prevention of dictatorial abuses.

So far as the limitation of dictatorial discretion is concerned, martial rule occupies a position rather different from that of the state of siege. Reliance on judicial rather than on legislative checks is the feature most clearly distinguishing the common law institution from its civil law counterpart. When an English or American executive feels that the reign of law is being seriously threatened, there is no need for him to apply to the legislature, as in France, for power to deal with the situation. His own inherent right to take necessary measures for the restoration of order is quite sufficient for most practical purposes. Legislatures may occasionally see fit to challenge his discretion in these matters. In England a vote of no confidence would be sufficient to terminate the activities of a government considered guilty of dictatorial abuses. Impeachment would provide a similar, though clumsier, resource in countries like the United States. But these are relatively uncommon devices, not specifically associated with the problem of constitutional dictatorship. In all common law countries the normal practice is to leave executives free in the exercise of martial rule until such time as their activities shall have been successfully challenged in a regular court of law.

This extreme reliance on the judiciary is entirely in harmony with the common law tradition. In the English-speaking world it is generally recognized as a principle of public law that government officials should be prepared at all times to go before the regular judicial authorities to defend the legitimacy of their acts. This applies to emergency measures no less than to ordinary acts of government. The civil law tradition permits a court to challenge the formal propriety but not the factual necessity of dictatorial action. In England and America the courts are subject to no similar restriction. A government official whose use of martial rule is challenged has no other way of avoiding judicial censure than to give evidence that his acts were "reasonably necessary" under the circumstances. When a judge is allowed to consider the actual necessity as well as the formal propriety of emergency action, there is nothing to prevent him from playing an active part in the prevention of dictatorial abuses. This is the authority on which common law countries rely primarily for attainment of that end.

On this point, as on so many others, adherents of the common

law are extremely fond of thanking God that they are not as other men. And the fact is that, from the standpoint of achieving a truly independent check on administrative dictatorship, there is a good deal to be said for judicial as compared with legislative action. Although true impartiality is hardly to be expected from any human being, this is an ideal more fully developed in the judiciary than in any other branch of public life. Years of professional training and a highly elaborate standard of professional ethics both contribute toward this result. Security of tenure also serves to foster a relatively independent point of view. Judges appointed for life or for long periods of years are rather less apt than legislatures to be concerned with the advancement of immediate party ends. The danger of partisan bias is comparatively remote, therefore, when responsibility for the supervision of emergency powers is placed in their hands. In this respect at least, the institution of martial rule may be said to represent a very real improvement over the situation as it exists in civil law countries.

The great weakness of the system lies in the fact that the resulting check is essentially negative in character. In France the state of siege has no legal standing until it has been given positive legislative approval. This insures that someone other than the dictator himself will at least initially have to pass on the need for dictatorial measures. No comparable restraint is to be found, however, in the case of martial rule. Instead of resting, as in France, with the authority who seeks to *justify* the employment of emergency measures, the burden of positive action is now placed on the person who seeks to *challenge* the legitimacy of those measures. Until it has been condemned by a court of law, no one is in a position to state authoritatively that a given use of martial rule is not legitimate. The courts have no right, moreover, to take the initiative in condemning the illegal use of emergency powers. As strictly judicial bodies they are not bound to act until some case involving the point at issue has been brought before them by a bona fide complainant, who must ordinarily be in a position to show that he has already suffered injuries sufficient to give him a proper cause of action. All challenges to martial rule are bound, therefore, to come more or less after the event. The purely negative right of rejecting something already in existence is all that the courts are expected to exercise in matters of this sort. The result leaves much to be desired from the standpoint of effective constitutional dictatorship.

In the first place, judicial proceedings are so slow and protracted that it is entirely possible for the legitimacy of martial rule to remain undecided throughout the period of emergency. Sometimes the condition of the country is so disturbed that the courts are entirely unable to hold sessions. Even when they are able to take immediate action there is apt, moreover, to be a considerable interval between the initial proceedings and final settlement of the case. In controversies involving martial rule, as in others, the decisions of lower courts are subject to appeals and other time-consuming devices. What with one thing or another, the last word regarding the legality of dictatorial measures in England or America is not usually said until long after the return to normal conditions. The celebrated case *Ex parte Milligan* [4] which held that the activities of courts martial during the American Civil War were in some respects unconstitutional, was not decided until the year 1866. The previously mentioned decision of Justice Holmes with regard to the use of martial rule in Colorado came at an even longer interval after the restoration of order in the troubled mining districts.

To say that the operation of judicial review is apt to be delayed is not, of course, to say that it is meaningless. The anticipation of subsequent inquiries is a possible check upon the tendency toward excessive enthusiasm in the use of emergency powers. Even greater effectiveness would be likely to result, however, from something a little bit more immediate in the way of supervision and control.

Because of its reliance on purely negative checks, the common law system has the unfortunate consequence, moreover, of enabling a dictator to prolong his own powers indefinitely through the use of obstructive tactics. In view of the fact that martial rule is to be presumed legitimate until a court of law has determined otherwise, the obvious line of conduct for an embarrassed executive is to prevent the court from acting. This can be done quite simply on the basis of martial rule itself.

The point is well illustrated by the experience of no less illustrious an American hero than Andrew Jackson. For several weeks after his victory in the battle of New Orleans, General Jackson continued to govern the city on the basis of martial rule. In view of the fact that the need for emergency measures seemed a thing of the past, the federal district judge ventured to issue a writ of

[4] 4 Wallace 2 (1866).

habeas corpus on behalf of a person whom Jackson was trying to court-martial. This inquiry into the propriety of martial rule was forestalled by the eminently simple device of having the judge who issued the writ and the sheriff who tried to serve it both arrested on a charge of "exciting mutiny." When the period of martial rule came to an end, the General did not fare any too well. Shortly after his release the indignant judge proceeded to soothe his ruffled feelings by fining Jackson one thousand dollars for contempt of court, a phrase seldom applied with more discriminating justice. This left the judicial branch with very much the last word in the argument. No happy ending should, however, be permitted to obscure the fact that the General was able for a considerable period of time, through the use of his emergency powers, to prevent the legitimacy of those same powers from being authoritatively examined. If he had not seen fit, as a loyal citizen, to abandon martial rule of his own volition and submit to the jurisdiction of the court, this situation might have been prolonged indefinitely. The inadequacy of a purely negative check could hardly be more tellingly displayed.

Any general survey of modern administrative dictatorship is bound, therefore, to leave serious misgivings. So far as the scope of emergency authority is concerned, emergency institutions of the present day leave little or nothing to be desired. The state of siege and martial rule are both entirely adequate as a means of liberating administrative action from constitutional restraints. Through one or the other of these institutions, the need for emergency powers has been amply recognized in the practice of all liberal governments.

The scope of modern dictatorial authority makes it all the more vital, however, that adequate safeguards be erected against the abuse of that authority. This is a point on which the existing situation proves upon examination to be far less satisfactory. In their attempts to provide an independent authority to limit the discretionary powers of the dictator, the civil and the common law systems have both fallen into serious and at the same time curiously complementary errors. The state of siege has the advantage of providing an effective positive check, but fails to vest it in a truly independent authority. Martial rule places the function of control in a truly independent authority, but limits that authority to the use of negative checks which are dangerously easy to evade. In neither case can it be said that there has been discovered a

fully satisfactory approach to the standards of effective constitutional dictatorship.

THE PROBLEM OF LEGISLATIVE DICTATORSHIP

The state of siege and martial rule are both designed primarily for the purpose of securing effective emergency action in the field of administration. This, as we have seen, is the main problem of constitutional dictatorship. Under the conditions of modern life emergency breakdown is also possible, however, in the process of legislation. In a city state like ancient Rome, where social and political organization stood at a comparatively simple level, there was no great difficulty in satisfying all legislative needs by normal legislative methods. A direct popular assembly which in any case was practically identical with the citizen militia could always be brought together in time to deal with the relatively nontechnical problems arising in so small and primitive a community. This made it possible to restrict Roman dictators to purely administrative functions. Similar possibilities are not available under the complex social and political conditions of the modern nation state. Representative bodies drawn from all parts of a large territory and dealing with a mass of highly technical legislation are forced in the very nature of things to adopt more elaborate and cumbersome methods than the direct assembly of a small urban community. Like all highly specialized procedures, the legislative methods of a modern nation state are relatively incapable of meeting the needs of unusual situations. The resulting dangers of emergency breakdown can be met only by providing alternative forms of emergency legislation. This is the problem of legislative dictatorship.

The need for emergency measures may arise out of some purely technical failure of the normal legislative process. One major weakness of modern parliamentary government is to be found, for example, in the fact that representative assemblies cannot at all times be kept in readiness for immediate action. If representatives are to maintain adequate contact with their distant constituencies, it is necessary that they spend a good deal of time away from the capital. The result is that most modern legislatures plan to remain in recess during a substantial part of the year. Since the work of legislation is essentially intermittent, no objection is ordinarily to be found with this arrangement. From the standpoint of effective emergency action, however, interludes of this sort are

a very definite point of weakness. A legislature once dispersed can seldom be brought together again within less than a week. In countries where it is customary to dissolve one body before electing its successor there may even be a period of months before parliament is once again in a position to resume its functions. There is always a possibility, on the other hand, that some unforeseen emergency may arise to call for immediate legislative action. In the absence of regular legislative authorities, this need can only be met by an appeal to some form of emergency action. This is one of the major causes of modern legislative dictatorship.

Even when parliament is in session, moreover, the danger of technical breakdown is by no means wholly eliminated. Modern legislation tends in normal times to be a slow and deliberate affair. The whole elaborate system of parliamentary procedure, with its committee hearings, its repeated readings, and its scrupulous attention to debate, is designed for the express purpose of preventing any sort of action from being taken without long and mature consideration. Arrangements of this sort are admirable so long as there is only a limited amount of legislative work to be done. But there are certain emergencies, such as a protracted war or a major business depression, which have the effect of calling for a sudden marked increase in the volume of legislation. Under these circumstances, the only possible way of preventing the legislative machinery from breaking down is to adopt some more immediately effective type of legislative action.

The more serious forms of modern legislative collapse are apt, however, to be political rather than merely technical in character. Under the rules of parliamentary life, positive action of any sort depends upon the support of an absolute majority. Because of the great diversity of interests in any modern state, the creation of such a majority is a feat calling at the best of times for a good deal of political dexterity. The nature of the problem is most clearly visible in bodies like the French parliament, where the lack of any single majority party makes all action depend on a process of bargaining and coalition. In countries like England, where single parties do often achieve a majority, the same process of bargaining is carried on between various factions within the party. The art of manipulating interests in such a way as to secure a working legislative majority is one of the basic tasks of liberal statesmanship. If the cleavage between various factions becomes too intense, the task becomes more and more difficult, and occa-

sions may well arise when it can no longer be solved at all. The resulting political bankruptcy can only be met by a resort to something other than the normal forms of parliamentary action. Providing a solution for political crises of this sort is one of the most serious problems of modern legislative dictatorship.

Now whether the cause of breakdown be technical or political in character, the easiest way of dealing with the situation is to vest emergency powers of legislation in the executive branch of government. Executive authorities differ from legislatures in that they are always in a position for immediate action. Continuous legislation is not a necessary feature of modern political life. As a matter of fact, business men are very apt to greet the end of a legislative session with audible sighs of relief. Obvious social necessities require, on the other hand, that the complex administrative machinery of a modern nation state be kept constantly in motion. The stockbroker who rejoices in the prospect of a legislative holiday would be distinctly less pleased to learn that the postal service was also to be discontinued during the summer months. The result is that all modern countries have had to recognize the need of keeping executive authority available for action at all times. It is true that, in countries where the life of cabinets depends on the maintenance of parliamentary majorities, there may be occasional gaps in the continuity of government. Even in these cases, however, it is usually found necessary to provide some permanent executive officer, king or president, who stands ready to assume control in periods of parliamentary crisis. Basic needs call for the maintenance of a continuously active authority in the executive realm. In connection with legislative even more clearly than with administrative dictatorship, this authority is the natural one on which to rely for the conduct of emergency action.

This conclusion is received with marked reluctance, however, in most liberal states. So far as administrative dictatorship is concerned, we have seen that the modern tendency, if anything, has been toward excessive prodigality in ascribing emergency prerogatives to the executive. Even in liberal states the tradition of a highly centralized executive is so strong that the prospect of temporary administrative despotism is greeted with relative indifference. But as soon as there is any question of extending this authority into the realm of legislation, serious forces of resistance quickly begin to make themselves felt. Ever since the period of the English revolution, modern experiments in constitutional gov-

ernment have all revolved around the attempt to establish and maintain parliaments as an independent political force capable of counterbalancing the executive establishment. This has been achieved largely by giving them an effective monopoly of legislative power. Under these conditions anything tending to impair that monopoly is apt to appear as a threat to the existence of constitutional government. The result has been to make liberal states extremely cautious in granting any sort of legislative prerogatives to the executive. Not even the need for effective emergency action has been able fully to overcome a reluctance so deeply rooted in the traditions of modern constitutional government.

This caution is based, moreover, on a good deal of genuinely painful experience. The reign of Charles X in France provides an interesting case in point. Under the Charte of 1814, one of the earliest experiments in constitutional monarchy, extensive powers of emergency legislation were recognized as a part of the royal prerogative. According to the text of Article 14, the king was empowered to issue all ordinances "necessary for the execution of the laws and the security of the state." The result was most unfortunate. So long as the shrewd and easygoing Louis XVIII remained on the throne, the constitution was secure. His reactionary successor, Charles X, was much less willing, however, to be bound by constitutional restraints, and it was not long before Article 14 suggested itself as a convenient means of accomplishing his purposes. The crucial moment finally arrived in the summer of 1830. Disturbed by the adverse trend of recent elections, the king decided that the time had come for a decisive assertion of his authority. On July 25 he accordingly proceeded to issue six drastic emergency ordinances, the most important of which were designed to abolish freedom of the press and to disenfranchise all but a small proportion of the existing electorate. The obvious purpose of all this was to overthrow the constitution in the interest of extreme reaction. From the standpoint of constitutional government, it would be hard to imagine a more blatant abuse of emergency powers.

The natural result of this experience was to make the French especially sensitive to the danger of this particular form of emergency action. It is true that Charles X did not actually succeed in his attempt to subvert the constitution by these means. The celebrated July ordinances were promptly followed by the even more

celebrated July revolution. The king was sent packing, and a much more liberal monarchy established under his complaisant relative, Louis Philippe. But even though no lasting harm actually came to French constitutionalism through the use of Article 14, there was no mistaking the dangerous implications of the episode. Under the constitution of 1830 nothing at all was said, therefore, about giving the king a right to issue emergency decrees. From that day to this there has been no attempt to revive legislation by prerogative as a method of constitutional dictatorship in France.

Something a good deal more conclusive than this would be needed, however, to prove the inadvisability of this particular form of emergency action. Genuinely alarming as were the actions of Charles X, the drafting of Article 14 itself was so faulty that it would be unwise to draw general conclusions from the episode. No emergency institution can be regarded as living up to the most elementary standards of safety unless it imposes an independent check of some sort upon the discretion of the prospective dictator. Under the Charte of 1814 this need was entirely overlooked. The right of issuing emergency ordinances was placed purely and simply in the hands of the king, with no further qualifications whatsoever. Against the possibility that these powers would be abused, no legal recourse of any kind was provided. The result was that, in the face of blatant usurpation on the part of the king, revolution was the only possible remedy. Such a situation is clearly intolerable from the standpoint of constitutional government. More adequate arrangements might well have served, however, to provide the advantages of emergency legislation under conditions of rather greater security. Before any general conclusions can be ventured on the subject, this is a possibility which needs to be more thoroughly investigated.

In order to show that the problem is capable of being solved a good deal more satisfactorily than in the French Charte of 1814, it is only necessary to appeal to the parallel experiences of Germany. During the middle years of the nineteenth century the various German-speaking principalities were all moving in the direction of constitutional monarchy. This brought them face to face, in much the same way as the French monarchs of a preceding generation, with the problem of constitutional dictatorship. The need for rapid legislation in periods of crisis led most of these countries to recognize the monarch as having a right to issue emergency ordinances. Made wise by the experience of France,

however, the German constitution-builders were on the whole much more careful than the framers of the Charte to guard against the accompanying dangers of abuse. One almost universal device was to confine the right of issuing emergency ordinances to those periods when the legislature was not in session. In order that the executive authorities might not be left with the last word in matters of such crucial importance, most of the German constitutions further provided that legislation issued on this basis should lapse unless ratified within a certain period of time by parliament. Under the Austrian constitution of 1867, for example, it was expressly stated that all emergency measures should be laid before the legislature at the beginning of its next session, and ratified within four weeks of that date. Through arrangements of this sort many of the German principalities came within measurable distance of reaching a really satisfactory basis for legislative dictatorship.

No widespread attempt was ever made, however, to profit by these promising beginnings. The newly, and for the most part reluctantly, constitutional monarchs of Germany were glad to accept an arrangement which left at least some traces of their former legislative powers. For similar reasons the institution also appealed to the Japanese. Emergency provisions directly copied after the prevailing German model were included as Article 8 of the Japanese constitution of 1890. But as a general contribution to the technique of modern constitutional government these experiments were almost wholly disregarded. Among the supporters of political liberalism it was regularly assumed that the granting of legislative prerogatives to an executive, under any conditions whatsoever, could only be taken as a sign of political immaturity. The collapse of constitutional monarchy in Central Europe after the World War led, therefore, to the disappearance of all these particular experiments in constitutional dictatorship. The only present representative of this once extensive class of institutions is to be found in Japan. The fact merely serves to confirm the general impression that efforts in this direction are appropriate only to the less advanced stages of constitutional development.

In this respect, as in so many others, the history of England differs from that of the Continent mainly by being somewhat premature. The evolution of constitutional sentiment which took place in France and Germany in the nineteenth and twentieth centuries had already been largely accomplished in England by the

end of the eighteenth century. During the earlier days of British constitutionalism, the right to issue emergency ordinances for the defense of the realm was accepted without question as a part of the royal prerogative. Even Locke, the official Whig theorist, found no difficulty in recognizing this as a proper function of the king. Ever since that time, however, legal opinion in England, as elsewhere, has shown constant tendency to move away from the idea of reckoning any sort of emergency legislation as one of the inherent powers of the Crown.

The question arose in its clearest form during the year 1766. At this time a serious crop shortage led the government, at a moment when Parliament was not in session, to declare an embargo on the export of grain. The matter came up for discussion at the very next session. In his speech from the throne, the monarch as spokesman for the government saw fit to justify the steps taken by declaring that, in view of the fact that Parliament was for the time being incapable of action, "the urgency of necessity called upon me in the meantime to exert my royal authority for the preservation of the public safety against a growing calamity which could admit of no delay." [5] This statement gave rise to the only considerable debate on these matters ever heard in the Mother of Parliaments.

So far as the wisdom of the embargo itself was concerned, there was little or no ground for argument. The form under which it had been ordered gave rise, however, to a number of interesting questions. Many of the members thought that the royal prerogative was in itself a sufficient basis for emergency legislation. Others felt that the government had exceeded its constitutional powers, and that a parliamentary act of indemnity would be technically necessary to relieve it of legal liability. From the debates it is by no means clear which, if either, of the two sides was in the majority. It is true that an act of indemnity was actually adopted, but this may have been due rather to a desire to play safe than to any deep-seated conviction as to the legal necessity of the step. Even at the present time there are jurists of standing who believe that emergency legislation is still a part of the royal prerogative. The fact remains, however, that from that day to this no further attempt has ever been made in practice to rely on the prerogative as a basis for legislative acts. Long before the exploits of Charles X had served as a warning to the continent

[5] *Hansard*, XVI, 236.

of Europe, emergency ordinance powers had already dropped quietly out of the picture as a living usage of the British constitution.

Now in view of this wholesale refusal to provide a legal basis for legislative dictatorship, a naïvely literal-minded observer might be tempted to conclude that this particular form of emergency action had been allowed to play no part in modern constitutional practice. Nothing could be further from the truth. We have already seen that a certain need for legislative dictatorship is implicit in the very structure of parliamentary government. We have also seen that this need cannot ordinarily be satisfied under existing constitutional arrangements. To expect the story to stop at this point would be most unwarranted. When important social needs cannot be satisfied under the forms of law, the normal tendency is to seek satisfaction through somewhat less formal means. Every good American of the present generation is familiar with the providential way in which prohibition evoked the bootlegger. In the relatively modest case of legislative dictatorship similar forces are at work. The refusal of liberal constitutions to recognize the executive as possessing legislative prerogatives has not been any more effective than alcoholic prohibition in preventing men from straying onto forbidden preserves. Human ingenuity can usually be trusted to accomplish any result of vital human importance.

The method ordinarily used to circumvent the ban of legislative dictatorship is the one already indicated in the case of the British embargo. When faced with an emergency that calls for immediate legislative action, a conscientious executive normally proceeds on his own initiative to issue such orders as the circumstances may seem to require. A threatened food shortage is met, for example, with an embargo on the export of grain. Under the existing state of law this may well be an act of sheer usurpation on the part of the executive. If a case involving the point at issue were brought before the courts, no defense could be offered to free him or his agents from any legal liabilities that might be incurred in the process. Considerable time is needed, however, for the completion of most legal procedures. The essential trick in such cases is to have the executive perfect his legal position before there has been any effective chance to challenge it. In the crisis of 1766 Parliament relieved the government of all responsibility by adopting the executive order as its own, and by passing an act of indemnity as

protection against any liability previously incurred. By this simple procedure all the advantages of prompt legislative action were achieved without the unpleasant necessity of recognizing emergency legislation as a part of the royal prerogative.

Under similar circumstances other constitutional states have adopted similar methods. The dictatorship of President Lincoln is an interesting case in point. At the outbreak of the Civil War the federal government found that it would be necessary to increase its military effectives as rapidly as possible. The only way of doing this legitimately would have been through an act of Congress. Unfortunately Congress was not in session at the time, and could not possibly be convened for several weeks at least. President Lincoln accordingly proceeded on his own initiative to order a drastic increase in the size of the army. Although he himself frankly admitted the illegality of the action, he relied on the country to support him in a course of such manifest necessity. This confidence was not misplaced. When Congress reconvened it proceeded at once to confirm all the president's measures. Later on it was also thought advisable to pass a bill of indemnity protecting him against the consequences of this and other illegal acts. The striking similarity of this procedure to that adopted in England is in itself enough to show that this is one of the more widely felt needs of modern constitutional government.

From a purely practical standpoint there is much to be said for this particular form of legislative dictatorship. As a method of combining effective emergency action with ultimate parliamentary control it is even preferable in some respects to the ordinance provisions of pre-war Germany. The power of a German legislature in matters of this sort was limited to the right of ultimate rejection. Although this might serve to prevent the indefinite continuance of unjustified emergency measures, it did nothing to inhibit the prince's freedom of action during those periods when parliament was not in session. The consequent temptation to hold off legislative sessions as long as possible was a very obvious weakness in the situation. In the case of dictatorship by usurpation, on the other hand, the situation is quite the reverse. When a man is at his peril to secure legislative authorization for acts otherwise illegal, he is under the strongest possible compulsion to hasten rather than to retard the resumption of normal parliamentary functions. The fact that he is personally liable for the consequences of all acts which the legislature cannot be persuaded to

ratify will serve, moreover, as a powerful deterrent to the wanton and indefensible use of dictatorial powers. As a check against possible abuses an arrangement of this sort has much to recommend it.

The intrinsic illegality of the proceedings is enough, however, to keep this from counting as a really satisfactory form of constitutional dictatorship. It is true that, considering the regularity of its occurrence, this might possibly be interpreted as one of the many unwritten but none the less legitimate conventions of modern constitutional government. In a matter of such importance it is particularly necessary, however, that the validity and scope of emergency action be very clearly defined. Such definition can hardly be achieved through the mere accumulation of constitutional precedents, which must in the very nature of things be few and far between. In the face of temporary emergencies nothing is more vital than the maintenance of respect for law. Above all, it is necessary to avoid the impression that extraordinary needs can only be satisfied by extralegal means. The modern practice of dictatorship by usurpation is far too irregular and vague to be judged entirely guiltless of this very serious fault.

In dealing with the problem of legislative dictatorship modern governments have been even less successful, therefore, than in their arrangements for emergency action in the administrative realm. An extreme desire to safeguard the position of parliamentary bodies has persuaded most liberal constitution-makers to strike emergency legislation entirely from the list of executive prerogatives. After the casual irresponsibility of these same liberals in their dealings with administrative dictatorship, this sudden access of caution is distinctly refreshing. Unfortunately, extreme measures are not always the most effective means of dealing with a recognized evil. The effect of a hopeless attempt to enforce absolute prohibition in America was to delay by a generation the adoption of rational methods of liquor control. The refusal of modern statesmen to set up regular forms of legislative dictatorship has been followed by very similar results. In view of the actual necessities it has not in fact been possible to prevent executives from an occasional assumption of legislative powers. Failure to regularize the process has served, on the other hand, to keep these powers from being surrounded by any really adequate restraints. The result is a serious gap in the emergency resources of modern constitutional government.

DICTATORSHIP BY DELEGATION

In the preceding pages we have had occasion to mention some of the difficulties arising out of the modern reluctance to admit executive prerogatives in the field of emergency legislation. Dictatorship by prerogative is not, however, the only conceivable means of satisfying the need for legislative dictatorship. It is true that there are some crises which can be met only in this way. If the need for legislation arises at a time when the regular legislative authorities are for some reason incapable of taking positive action, the executive has no choice but to act on his own authority. But there are also occasions when the legislature, without being entirely adequate to the needs of the existing situation, is at least in a position to assume positive responsibility for the conduct of affairs. The method usually adopted in such a situation is to delegate legislative powers to the executive branch of government.

Considering that the final result in either case is to vest a mere executive with the right of legislation, this might seem on the face of things to be practically indistinguishable from dictatorship by prerogative. The doctrine of parliamentary supremacy is much better served, however, by having the executive act as a chosen agent of the legislature than by allowing it to act by its own inherent authority. Under the conditions of modern constitutional government dictatorship by delegation has therefore come to be recognized as the most suitable form of legislative dictatorship.

The legal basis for an act of delegation is simple in the extreme. In its essence it is nothing more than an extension of the realm of public law of certain principles governing the private law institution of agency. When in the conduct of his daily affairs a private citizen finds himself unable to perform certain necessary actions on his own behalf, he is usually allowed to appoint someone else to act in his place. According to the nature of the task in hand, the powers of the agent may be broad or narrow in scope. They may also be withdrawn at any time the principal sees fit. Within the limits of his commission the acts of the agent are just as binding, however, as if they had been performed by the principal himself. The result is to permit many things to be done which the principal in his own natural person would have been quite incapable of performing.

In the case of dictatorship by delegation the private law rela-

tionship of principal and agent is simply invoked as an emergency measure to govern the relations between the legislative and executive branches of government. When parliament feels itself unable to cope with the requirements of a given situation, it appoints the executive to act as its agent in the matter. The commission granted may be just as broad and just as narrow as the circumstances seem to require. It may also be withdrawn whenever parliament so desires. Within the limits set by the act of delegation the executive is able to perform all the legislative functions normally vested in parliament. The result is to provide a more than ample basis for legislative dictatorship.

The method of dictatorship by delegation is not by any means a recent discovery. As a really important feature of modern government it very largely dates, however, from the period of the World War. The unprecedented efforts made in the course of that conflict to marshal social and economic forces in the service of military action served to produce an immediate increase in the volume and importance of legislative action. This led in practically all the belligerent nations to a legislative breakdown which could only be met by resorting to the method of delegation. In this respect there is little to choose between the experience respectively of the Allied and of the Central Powers. It is true that the United States was able to get along with relatively little deviation from the regular forms of legislative action. A nation removed from the actual scene of hostilities by several thousand miles could afford to be more or less leisurely in its approach to wartime problems. But this was an advantage which few of the belligerents were in a position to enjoy. The result was to make this a period of very general experimentation in the resources of dictatorship by delegation.

Of all the belligerent nations none went farther in this respect than England. Shortly after the outbreak of hostilities a measure known as the Defense of the Realm Act[6] was rushed through Parliament for the purpose, among other things, of authorizing the king in council for the duration of the conflict "to issue regulations . . . for securing the public welfare and defense of the realm." The delegation of legislative functions could hardly be effected in more sweeping terms.

For five whole years thereafter executive legislation never ceased to play an important part in the political life of the country.

[6] 4 and 5 Geo. V, 29.

Several hundred decrees were ultimately issued on this basis, some of trifling and others of very considerable importance. Many were connected only in the remotest possible way with the actual conduct of hostilities. A good deal of attention was given, for example, to the licensing of dogs and dog shows. Partly as a result of growing prohibitionist sentiment the act was also used with particular insistence for the issuance of regulations harassing the liquor traffic. This soon led to an unfavorable reaction in merrie England circles. In the course of time the slow-moving but dependable readers of *Punch* were taught to identify DORA with one of the most sourly spinsterish figures the cartoonists could devise. The rigors of total warfare are such, however, that even dog shows and barrooms cannot be necessarily excluded from the range of legitimate military interest. The British public was supremely anxious to win the war. So long as the conflict continued this fact would have been enough to insure the acceptance of a lady far less appealing than the DORA of *Punch's* imagination.

Of all the wartime acts of delegation, the Defense of the Realm Act was probably the most drastic. It can hardly be said to have been more extreme, however, than some of the measures employed in subsequent peacetime crises. The late and rarely lamented National Industrial Recovery Act purported, for example, to hoist the United States into a more abundant life by giving the president almost unlimited authority to issue regulations in the economic realm. From a political standpoint this was the most startling consequence of the great American depression. In France developments of very much the same general character have taken place from time to time in the course of a perennial campaign to save the franc. The law of June 8, 1935, which vested the Laval government with the power of issuing decrees "to combat speculation and defend the franc," [7] was clearly intended and actually used as the basis for economic measures of a most far-reaching sort. Economic depressions have been almost as effective as warfare in encouraging modern governments to experiment with the resources of dictatorship by delegation.

There is one important point of difference, however, between the legislative crises respectively of the wartime and of the subsequent peacetime period. During the war political conflict played hardly any part in the breakdown of normal parliamentary func-

[7] *Journal Officiel, Doc. Parl. Chambre*, 1935, Annexe Nr. 5398.

tions. At a time when political differences were being submerged in a wave of patriotism, legislatures were disposed to be more than ordinarily amenable to the wishes of their respective governments. Overwhelming majorities were to be had almost for the asking. Under these circumstances the sole reason for resorting to emergency forms of legislation was to be found in the purely technical disadvantages of normal parliamentary procedure. In a number of post-war crises, on the other hand, the problem of maintaining parliamentary majorities has been a matter of very real concern. The recurrent difficulties of France have been largely due, for example, to the inability of governments to secure normal legislative support for budgetary and other measures needed in defense of the franc. Parliamentary intransigence has not been equally prominent in all post-war crises. It would be hard indeed to ask for a more compliant legislature than the American Congress which passed the NRA. Some breakdown in the political as well as the merely technical processes of legislation is to be found, however, in connection with a goodly proportion of all the more recent experiments in legislative dictatorship. This fact is enough to distinguish them from the wartime acts of delegation.

The relatively political character of recent legislative crises is largely due to the circumstance that the problems of the post-war period have been economic rather than military in character. Under the conditions of modern life the usual tendency of economic stringency is to sharpen the intensity of political cleavages. The idea that depression may be a national problem calling for united national effort is much less familiar than the idea of national effort in time of war. Whereas military activities have been accepted for centuries as an exclusively governmental function, it has long been customary to look upon business enterprise as a responsibility of the individual. This means that any threat to economic well-being will tend to be regarded from an individual rather than from a social point of view.

When government action serves to maintain or increase the individual standard of living there is no great difficulty in securing popular support. There has never been any serious question regarding President Roosevelt's ability to command Congressional majorities for the policy of using government credit to counteract the effects of deflation in America. But when the exhaustion of government credit finally makes it necessary, as in France, to face the fact of a diminished standard of living, the political capacity

of the country is put to a much severer test. Each class of the community is strongly tempted to protect its own economic position by refusing to shoulder its share of the resulting sacrifices. Under these circumstances it becomes extremely difficult to secure majority support for any sort of positive action. In time of war common motives of patriotism can usually be relied upon to prevent individual selfishness from getting out of bounds. The absence of a similarly unifying force in time of peace is one of the main factors lying behind the recurrent post-war breakdown of legislative functions.

Although the need for legislative dictatorship under these circumstances is perfectly easy to understand, it is much less easy to see how that need could ever be satisfied by the method of delegation. In crises of this particular sort the main difficulty arises out of the inability of parliamentary majorities to agree on a common line of action. The passage of an enabling act is impossible without the positive coöperation of a legislative majority. From these premises it would seem to follow that dictatorship by delegation must remain without value as a method of counteracting political stoppages of the legislative process.

The experience of France alone is enough to show, however, that there is nothing conclusive about this particular line of reasoning. At the crucial moments of post-war financial retrenchment, French parliaments have repeatedly found themselves in a position where they simply did not dare to take the risk of imposing sacrifices upon politically powerful elements of the community. Governments have collapsed with tireless regularity under the resulting strain. And yet the very parliaments that would not venture to act on their own behalf have frequently been willing to authorize similar action by the government. In 1926 legislators who had long refused to vote needful financial retrenchments through fear of antagonizing the powerful public service organizations found courage enough to grant Poincaré the right of issuing decrees "for the suppression or merger of civil service positions." [8] In 1935 a similar period of parliamentary uncertainty was ended by an even more drastic delegation of legislative authority. Repeated experience of this sort would clearly seem to suggest that there must be circumstances which make it easier for parliaments to pass an act of delegation than to proceed by normal parliamentary methods.

[8] *Journal Officiel, Doc. Parl. Chambre*, 1926, Annexe Nr. 3255.

The explanation of this curious phenomenon is to be found in the fact that legislative bodies under the conditions of modern political life are peculiarly susceptible to the pressure of special interest groups. No representative can long afford to remain unresponsive to the demands of organizations which carry weight in the particular constituency to which he happens to owe his job. Whatever his private sentiments may be, the member for an important wine district can hardly afford to appear in public as a teetotaler. It may be true, as Burke maintained in his celebrated *Letter to the Sheriffs of Bristol*, that members of parliament ought to regard their duty as representatives of the nation as a whole even more highly than their duty to any particular constituency. The only trouble is that the votes of the particular constituency determine whether or not a man shall be a member of parliament. After his noble and persuasive challenge to the electors of Bristol, Burke himself was forced to continue his parliamentary career as a member from the pocket borough of Melton. The rarity of pocket boroughs at the present time has made modern representatives understandably reluctant to follow his example in defying local interests for the sake of a higher national good.

This is not to say that national sentiments are not also a factor to be reckoned with in modern political life. An apparent preference for special interests is often due to unawareness of the true incompatibility between them and other interests of a more general character. Nothing is more intensely human than a desire to have a cake and eat it too. In cases where the connection between having and eating is fairly indirect, the demand can even be made to sound quite plausible and humane. The great difficulty of modern tariff legislation lies, for example, in the fact that the advantage to particular interests is likely to be immediate and obvious, while the disadvantages are spread so thinly over the community that only a trained economist can apprehend them with any sort of vividness. But even though immediate concerns may tend to carry unusual weight, the fact remains that most individuals have a very real interest in the welfare of the larger community in which they live. In many cases it will be found to have a stronger emotional appeal than the particular interests with which it comes in conflict. Under these circumstances all that is needed to achieve unified national action is to make the issue between having and eating wholly clear and defi-

nite. This is one of the major tasks of contemporary statesmanship.

Under the conditions of modern political life no organ of government is nearly so well situated as the executive to achieve success in this direction. An ordinary member of parliament is able only within comparatively narrow limits to appeal to the conscience of the general public. The only sure way for him to attract national attention is to join the lunatic fringe and provide copy for the tabloids. This makes it hard for him to avoid standing or falling by the reaction of politically active groups in his own particular constituency. The executive head of a nation, on the other hand, is forced by his very position to appear as a spokesman for the country at large. Because of the high news value attaching to his lightest word, all the resources of modern publicity are his for the asking. Under such circumstances it is comparatively easy for him to resist particular pressures by appealing for the general support of the community. In the United States a long line of bonus vetoes bears witness to the fact that presidents are uniformly less susceptible than Congresses to the pressure of veteran organizations. This is a typical experience of modern constitutional government.

In periods of emergency it is particularly necessary to arouse public opinion against the depredations of special interest groups. The result is to place a special premium on executive action. Because of their inability to make the voters conscious of the incompatibility between their own private demands and the requirements of national welfare as a whole, private members of parliament are often unable to assume responsibility for the passage of measures they themselves recognize as desirable. Under these circumstances there is nothing left for them to do but to pass an enabling act. Because of his relatively strong position the executive is frequently able to undertake all necessary action without undue political risk. A dramatic and forceful presentation of the issues may be all that is needed to counteract the pressure of special interests. Dictatorship by delegation provides a convenient means of accomplishing this result. As such it has been able to assume a very considerable place in recent constitutional practice.

From the standpoint of providing safeguards against the danger of abuse, this is probably the most satisfactory form of constitutional dictatorship available at the present time. Parliamentary

control over the exercise of emergency authority is maintained by reason of the fact that the power to legislate is derived from a positive act of delegation which may be withdrawn at any time. As a further safeguard for the position of the regular legislative authorities, most enabling acts are limited to a specific period of time. The various wartime acts of delegation were passed for the duration of the war only, and subsequent measures have been even more narrowly limited. The Poincaré enabling act of August 3, 1926, was valid for the remainder of the year only, and none of its successors has been for a substantially longer term. No other form of emergency action has been so effectively safeguarded.

Of course it is true, as we have already seen in connection with the problem of administrative dictatorship, that common party loyalties tend to weaken the capacity of legislatures to act as a fully independent check on executive action. The danger of abusive collusion between the legislative and executive branches of government is much less acute, however, in legislative than in administrative matters. In the case of administrative dictatorship a legislature is asked to surrender the rights of other people. Since those other people are very apt to be members of a rival political organization, the community of interest between a legislative majority and its cabinet representatives is more or less complete. In the case of legislative dictatorship, on the other hand, the legislature is called upon to surrender its own legislative rights. The ability of the rank and file to control the actions of their leaders depends entirely upon the possession of these rights. Unless the party is so uncommonly well-disciplined as to overcome all the usual frictions between leaders and followers, it will not be disposed to weaken this control for anything less than adequate cause. The result is to protect this particular form of emergency action from many of the worst dangers of abuse.

With all its advantages dictatorship by delegation has not been accepted without opposition, however, as a feature of modern constitutional government. Long and painful experience has taught the supporters of political liberalism to set great store by the independence of legislatures. The greatest threat to that independence is, of course, to be found in the prerogative powers of the executive. Dictatorship by prerogative has for that reason been regarded at all times as the most dangerous form of legislative action. But the importance of legislative independence is so great that even the less dangerous forms have also remained in some

measure suspect. According to the more cautious supporters of constitutional government, the position of parliament should be made secure not only against the possibility of executive usurpation but also against the weaknesses of parliamentarians themselves. Mistakenly or wantonly, it is always possible that the process of delegation will be used by parliaments to destroy their own position. A recognition of this danger has led most countries to impose serious limitations upon this particular form of constitutional dictatorship.

The method of limitation adopted in most countries is based, like the process of delegation itself, on an analogy taken from the private law field of agency. In ancient Rome it was a generally accepted principle that a man who had received power by delegation from one person could not delegate that power to another. Like so many of the less defensible Roman maxims, the phrase, *potestas delegata non delegari potest*, has so harmonious and conclusive a sound that subsequent generations of lawyers have seldom dared to question it. For all their supposed sturdiness in the face of Roman law principles, the jurists of common law countries have been no less ready than their civil law brethren to recognize it as authoritative.

The result has been to give the ancient Romans much influence upon the development of modern legislative dictatorship. On the principle that governmental powers in a constitutional state are held by delegation from the authorities who create the constitution, the ancient maxim has frequently been invoked to deny modern parliaments the right of redelegating their constitutional powers to any other authority. Only the constituent power, from which all other powers are derived, has a right to alter the distribution of governmental functions. So long as it takes the form of a constitutional amendment an act of emergency delegation is entirely unobjectionable, but to accomplish the same result by a mere act of legislation is a violation of basic legal principle. In connection with a problem entirely unknown to the ancient Romans, an ancient Roman maxim has thus been permitted to operate with surprisingly conclusive effect.

It is true that there is one important country where reverence for antiquity has not been allowed to take this particular form. Surprisingly enough, this country is the classic land of France. Before the war most French jurists were inclined to subscribe to the usual opinion that a constitutional amendment alone could

serve as a basis for dictatorship by delegation. Wartime experiences did something to shake their opinion, but even as late as 1926 there was still some question as to the legitimacy of delegation by ordinary act of parliament. When the franc crisis of that year led the Briand-Caillaux ministry to request legislation granting them extensive decree powers, "the impossibility of delegating legislative power" was maintained by no less influential a statesman than Herriot as "one of the organic and essential articles of the French republican creed." [9] The issue moved him so deeply that he even saw fit to take the unusual step of descending from the speaker's chair and participating in the debate.

Circumstances were not long favorable, however, to the maintenance of this eminently orthodox position. During the troubled days of the franc crisis there was an acute need for emergency legislation which could not easily have been satisfied through the cumbersome amending processes provided under the French constitution. This difficulty was finally overcome by the eminently simple device of forgetting all about the early Roman maxim. The change took place tacitly and with almost comic abruptness. Less than a month after his defense of republican principle against the Briand-Caillaux government, Herriot himself was to be found voting, with never a hint of constitutional misgivings, in favor of the Poincaré enabling act. No reference to the problem of redelegation is to be found in the debates on this or on any subsequent enabling act. By common agreement the whole thing was quietly and permanently dropped as a feature of French constitutional practice. The result was to permit a quite unusual degree of freedom in the development of dictatorship by delegation.

In most liberal countries the ancient prohibition still remains, however, as an obstacle to the passage of enabling acts. Perhaps the most striking expression of this fact is to be found in the more recent history of American constitutional law. Prior to 1934 the doctrine that Congress might not delegate its legislative powers was supported by nothing more compelling than a series of judicial dicta. Although the validity of such an act of delegation had been repeatedly denied in theory, the fact remained that no single act of Congress had ever been rejected on these grounds. This circumstance encouraged Congress, in the crisis conditions which prevailed at the beginning of the present Roosevelt administration,

[9] *Journal Officiel, Doc. Parl. Chambre*, Session of July 17, 1926, p. 2965.

to pass a number of acts vesting the executive with broad powers of emergency legislation. The most drastic of these measures was the famous National Industrial Recovery Act, which gave the president an almost unlimited right of issuing regulations for the control of industry. This was the straw which finally broke the camel's back. Within two years this grandiose experiment was brought to the ground by a unanimous decision of the Supreme Court holding the act void as an illegal delegation of legislative powers.[10] The continuing authority of an ancient Roman maxim could hardly have been expressed in more uncompromising or in more dramatic form.

The result has been to make dictatorship by delegation largely unavailable as an element in the political life of today. So long as the ban on redelegation is applied to the activity of legislatures, the forms of constitutional amendment are left as the only legitimate basis for the passage of enabling acts. It is true that the practical significance of this fact is not equally great in all countries. Much depends on the relative flexibility or inflexibility of amending provisions in the various constitutions of today. In England, where the forms of constituent and legislative action are identical, no one really cares whether an enabling act like our old friend DORA is a constitutional amendment or not. A bare parliamentary majority is all in either case that would be required for passage. In most countries, however, the amending process has been made appreciably more difficult than an ordinary act of legislation. So long as this differential exists, the ban on legislative delegation cannot fail to act in some measure as an obstacle to the use of legislative dictatorship, an obstacle amounting in some cases to virtual prohibition. This is most notably true in the United States, where the process of amendment is much too long and complicated ever to be considered as a basis for emergency action. Even in the relatively safe form of delegation the resources of legislative dictatorship have thus been placed beyond the reach of many constitutional states.

When modern emergency institutions are compared with those of ancient Rome it soon becomes apparent, therefore, that our present-day arrangements leave much to be desired. In the field of administrative dictatorship we have made the mistake of providing the executive with ample emergency powers and then failing to surround those powers with adequate limitations. In the field

[10] *Schechter Poultry Corp. v. U. S.*, 295 U. S. 495 (1935).

of legislative dictatorship we have made the curiously complementary mistake of devising adequate limitations and then proving niggardly in the use of the resulting institution. Nowhere is it possible to find that delicate balance between liberality and caution, so notable in the arrangements of ancient Rome, which is indispensable to any really successful solution of the problem.

Under these circumstances it is hard to say whether dictatorship ought, on the whole, to be reckoned as an element of strength or of weakness in the structure of modern constitutional government. We have seen that the powers granted are in some respects inadequate. In the face of this inadequacy, what services are they potentially capable of rendering to the cause of political liberalism? We have also seen that these same powers are in many cases insufficiently safeguarded against the danger of abuse. How serious is the resulting threat to the maintenance of liberal institutions? These are the complex and conflicting factors which would have to be weighed in reaching any true estimate as to the significance of modern constitutional dictatorship.[11]

[11] For an initial attempt to apply these criteria to the detailed analysis of a specific political context, see F. M. Watkins, *The Failure of Constitutional Emergency Powers under the German Republic* (Cambridge, Mass., 1939).

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* Compiled by Mrs. Helen W. Parsons.